

NESC REPORT NO. 80

**THE FINANCING OF
LOCAL AUTHORITIES**

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nesc

National
Economic and
Social Council

An Chomhairle
Náisiúnta Eacnamaíoch
agus Sóisialach

The Financing of
Local Authorities

No. 80

May 1985

NATIONAL ECONOMIC AND SOCIAL COUNCIL

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1. The main task of the National Economic and Social Council shall be to provide a forum for discussion of the principles relating to the efficient development of the national economy and the achievement of social justice, and to advise the Government, through the Taoiseach on their application. The Council shall have regard, inter alia, to:
 - (i) the realisation of the highest possible levels of employment at adequate reward,
 - (ii) the attainment of the highest sustainable rate of economic growth,
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 - (v) the balanced development of all regions in the country, and
 - (vi) the social implications of economic growth, including the need to protect the environment.
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 - Five persons nominated by the Confederation of Irish Industry and the Irish Employers' Confederation,
 - Five persons nominated by the Irish Congress of Trade Unions,
 - Five other persons appointed by the Government, including two from the National Youth Council of Ireland,The Secretaries of the Department of Finance and the Department of the Public Service.

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6. The numbers, remuneration and conditions of service of staff are subject to the approval of the Taoiseach.
7. The Council shall regulate its own procedure.

NATIONAL ECONOMIC AND SOCIAL COUNCIL

The Financing of Local Authorities

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PART I
THE COUNCIL'S COMMENTS ON THE FINANCING OF
LOCAL AUTHORITIES

THE FINANCING OF LOCAL AUTHORITIES: COUNCIL COMMENTS*

Context of the Study

1. In recent years there has been a significant upsurge of interest in local Government reform. This has been due to a number of factors, including questions about the most appropriate organisational arrangements for the delivery of services in the most cost effective manner, about how to ensure responsiveness to the needs of the community and the implications of population shifts for the structure of local Government. It has also been due, in no small part, to significant changes, in the last decade in the financing of local authorities.

2. The Council, in this study, concentrates on one aspect of reform, namely, the financing arrangements which are a matter of considerable debate and discussion at present in the context of general taxation policy. In so doing the Council was conscious of the fact that it was carrying out a study based on certain parameters, i.e. the existing structures and functional responsibilities, which were unlikely to remain unchanged. However, the Council believes that the general thrust and conclusions of the study undertaken are applicable under a range of structures and functional divisions.¹

3. The Council wishes to emphasise that undertaking a study of financing arrangements based on the existing structure and functional divisions does not necessarily imply general agreement with the existing structures and functions of local Government. It is used rather as a convenient working arrangement. The Council is aware that the Government has embarked on a fundamental review of the respective functions of the local and central Government systems. The Council itself intends to examine these issues in the course of its workprogramme and included

*Following discussions in the Council, these comments were drafted by Gerry Danaher Secretary of the Council and the final text was approved by the Council.

¹The I.F.A. view was that until such time as the optimum structure and the functions of local administration were decided upon no decision should be taken to confer powers on Local Authorities to raise direct income, other than, where necessary and applicable, the power to charge for services provided.

This view was formed in the belief that if the Council favours some specific form of local taxation which will be used to finance the existing structure then the whole reform of the structure that is necessary is unlikely to proceed.

in this examination could be the mode of provision of services and the consequent choice for consumers.

4. In order to examine the alternative financing arrangements the Council commissioned a study of local authority financing which is published as Part II of this report. The study was undertaken by a team headed by Professor C. Foster of Coopers and Lybrand, UK. The other members of the team were Mr Q. Thompson of Coopers and Lybrand, UK and Mr R. Jackman of the London School of Economics. The study was monitored by a steering group, chaired by Mr G. Tierney. The membership of the steering group is attached as Appendix I.

5. The Council Comments begin by examining the evolution of local authority financing arrangements over the last decade. This is followed by a section on *The Choices* regarding the direction which local authority financing can take. The main Local Revenue Sources are then outlined, followed by a discussion of the three main options. Having argued in favour of a particular option, the overall financing mix is considered. This is then followed by a detailed discussion of the preferred local revenue source and some concluding remarks.¹

Evolution of Local Authority Finances

6. Since the mid 1970s significant changes have occurred in the financing of local authorities. The major change has been the erosion of the local revenue base. In 1976 rates formed 41% of local authority revenue and 38% was accounted for by central Government grants. In 1984 the percentages were 12% and 64% respectively. Two major developments have contributed to this erosion: (i) the transfer of liability for the payment of domestic rates from ratepayers to central Government with the latter providing a grant in relief of domestic rates; (ii) the gradual increase in the grant in lieu of agricultural rates and ultimately the decision of the Supreme Court that the levying of agricultural rates on the basis of the Poor Law Valuation was unconstitutional.

7. When the Government accepted responsibility for the payment of a grant in lieu of domestic rates, the size of the grant was determined by the actual rate poundage adopted in each county. In order to protect the exchequer and the remaining rate payers the Government placed a ceiling on the size of the rate poundage increases from year to year. This constraint was removed in 1983. In addition, the local authorities were granted greater powers to charge for services. However, in conjunction with this "liberalisation", central Government began to limit

¹The Secretary of the Department of Finance who, is a member of the Council, did not participate in the discussion of those recommendations involving specific budgetary proposals.

the increase in the rate support grants. At the same time local authorities were facing difficulties in collecting the revenue from charges, resulting in a significant squeeze on their finances.

The Choices

8. The Council agrees with the consultants that without some change the already serious financing difficulties for local authorities will deteriorate further. A fundamental decision is now needed on the direction which local authority financing should take. The consultants do not offer a specific recommendation on this issue; rather they present options and suggest that the basic question is whether local authorities should have restored to them greater discretion to determine their overall levels of expenditure, or instead should they lose that discretion?

9. The consultants believe that it would be feasible to continue funding local authorities primarily by grants from central Government. However, they argue that if local authorities are to regain their traditional political powers and responsibilities and the ability to determine their own overall spending levels, it is necessary for financial accountability that they should have an independent source of revenue derived from those to whom they are electorally accountable. Even if they regain greater financial autonomy it does not necessarily follow that they will have greater discretion in how they spend money unless some of the controls exercised by central Government are relaxed.

10. However, the restoration of greater local autonomy (as distinct from an ability to determine spending levels) does not necessarily require an independent source of local revenue. Under a system based mainly on central funding a grant system can be designed which gives considerable local autonomy. The extent of local autonomy depends upon the mix of general and specific grants in the funding. In the case of general or block grants, funds are transferred from central to local Government without specific conditions attached regarding their disbursement. Local authorities, therefore, have control over their use but not over their size thus giving them a considerable degree of discretion. In the case of specific grants, resources are made available to local authorities from central Government with specific conditions attached. The purpose of specific grants is usually to ensure that central Government policies are fulfilled at the local level. In the case of specific grants local authorities act as agents of central Government. The changing composition of central Government grants in the last four years, with a rapid increase in specific grants and slow growth of general grants, has thus further curtailed the discretion of local authorities.

11. In assessing a grant system the implications of excessive reliance on one revenue source should be noted, particularly if the flow of funds from that source is interrupted. When the primary source of revenue is central Government grants, local authorities are subject to austerity measures decided at central Government level. Evidence of this is available from the limitation of the rate support grant in recent years and the commitment in the National Plan to further limitation over the course of the Plan period.

12. A means sometimes advanced of giving local authorities greater autonomy is the concept of a "shared" or "assigned" revenue system.¹ Such a system is normally discussed in the context of block grants. This shared revenue system involves the allocation of a share of the proceeds of specified taxes to local authorities. The transfer is similar to a block grant so long as the share is determined by central Government and is independent of the revenues raised in the local authority area. It is difficult to envisage central Government agreeing to an approach which allowed the local authorities to determine their share. A shared revenue system is therefore unlikely to allow any more discretion than does a block grant. Neither is it clear that the share would remain fixed in the face of budgetary stringency at central Government. It also may inhibit central Government from varying the overall structure of the tax system because of the effects on local authorities.

13. In summary, the Council believes that a considerable degree of local discretion can be maintained in a grant financed system. This could be achieved through the provision of specific grants for national services (i.e. where policy is laid down by central Government) and a block grant (subsuming the agricultural grant, the domestic rate relief grant and the block grant for roads) to cover other services. However, the Council believes that local authorities should have greater discretion to determine their own overall spending levels; in effect that they should have an independent source of revenue.

Local Revenue Sources

14. With regard to possible local revenue sources the consultants examined five options in all. Two are discussed only very briefly, namely, a local payroll tax and a local poll tax. Three major options are considered in detail:

- (i) local income tax
- (ii) local sales tax
- (iii) property tax

15. The consultants put forward six desirable characteristics of any local tax system. These characteristics are (para. 2.21 of consultants' report):

- accountability
- practicality
- fairness
- predictability
- variability
- compatibility

The consultants in arguing for compatibility with the national tax system discuss the overall impact of the tax system on economic efficiency and of the relationship of tax burdens with ability to pay. In examining possible local tax options the Council attaches a very high premium on a widening of the total tax base. The three major options are now examined against these criteria.

Local Income Tax

16. A local income tax scores well on some of the desirable characteristics which have been set out. It can bear a close relationship to ability to pay depending on the definition of income used and the applicability of the tax. It would be consistent with strengthening local financial accountability and is capable of substantial revenue yield.

The introduction of a local income tax would pose practical problems, however. A local income tax is most feasible under a system of year end assessment. The Irish income tax system is cumulative and so does not require end-year adjustments for all employees (although the necessity for end-year adjustments has been increasing). The administrative and compliance costs of moving to a system of universal year-end assessment, with all taxpayers filling tax returns each year, would be considerable. If one were to graft a local income tax onto the existing PAYE system it would be necessary for each employer to establish the place of residence of each of his employees and make different deductions for each according to residence which would be difficult and costly. In the Council's view, it is these practical difficulties which constitute one of the major factors militating against a local income tax.

17. Wider issues than administrative ones arise, however, and the case for the introduction of a local income tax must be examined against a background of the overall income tax system. The present system is

¹Dáil Debates, 24 January 1985, Col. 595.

unfair and inefficient with the main defects being: too narrow coverage; too many exemptions and allowances; and high marginal tax rates. Basing additional taxation on the existing income tax base would be likely to compound the inequity and inefficiency, and would introduce further complications including problems with investment income.

Local Sales Tax

18. The consultants argue that for a local sales tax to provide an independent source of revenue for local authorities each authority would need to be able to set the level of tax in its area and collect the proceeds. The main attractions of this form of tax are that it would be easy to collect and would be buoyant.

19. However, it does not fare well on the criteria of practicality, predictability and variability. On practicality the consultants refer to the existing number of VAT rates with which retailers are faced and foresee difficulties with another rate. They also question its acceptability to the European Community in the context of attempts by the Community to harmonise tax laws. On predictability and variability the consultants advert to the possibility of cross-authority shopping which would also break the link with electoral accountability. The Council in this connection notes that cross-border trading would be a factor to be taken into account. Finally, where trading across local authorities occurs, e.g. a manufacturer in one local authority selling to a retailer in another local authority, administrative complications arise.

Local Property Tax

20. The consultants argue that a property tax offers the best means of restoring a local revenue base to finance local Government. The Council agrees in principle with the introduction of a property tax and believes it would be practical, would ensure accountability and would provide local authorities with a predictable and variable source of finance. It would also be compatible with the national tax system and would widen the overall tax base. While a widening of the tax base is not an issue of relevance from the perspective of local authorities and was not specifically identified in the set of desirable characteristics, the Council attaches considerable weight to this objective. The Council has recommended a widening of the tax base in a number of reports over the past few years.

The Financing Mix

21. Before discussing the details of a property tax it is necessary to consider how a property tax might relate to the two other instru-

ments of local authority financing, i.e. central Government grants and local charges, and how the three might be combined in a coherent financing package. In this context one particular issue which is likely to arise is whether a property tax should replace any or all of the current charges for local services.¹ The most appropriate way of addressing that issue is to consider the most suitable source of financing the various activities of local authorities.

22. In general the Council believes that charges are a desirable instrument for financing the provision of some services. They provide a more direct link between consumption of a service and payment and have the desirable effect of countering a possible perception that many services provided by the Government are free. Where the benefit from a service is clearly identifiable as accruing to a particular individual and is essentially a private benefit then there is a strong case for that individual paying the full cost of provision and choosing whether or not to take the benefit of that service. The wider study which the Council contemplates (as referred to in paragraph three) will cover these issues. Equity considerations may entail rebates or cash supplements for those on low incomes.

23. However, notwithstanding the desirability of charging for some services, the scope for charging is limited in practice. Many services because of their very nature, do not lend themselves to charging on grounds of practicality and efficiency, e.g. street lighting. In some cases, while the benefit of a service might be clearly identifiable as accruing to an individual, the levying of a charge per unit consumed may not be feasible because of measurement difficulties. In such cases the charge levied becomes a flat rate payment akin to a tax. The consultants acknowledge that while there is scope for increasing the yield from charges from its present level the scope is limited by the redistributive or public good nature of some of the services provided. The Council believes that charges should bear some relation to usage. Where this is not possible, the Council believes that taxation is a more appropriate mode of financing.

24. In recommending the introduction of a property tax it should be noted that the Council did not envisage the overall volume of resources available to local authorities being augmented by the receipts from this tax. Rather, the Council envisaged a restructuring of the finances of

¹The National Planning Board in Proposals for Plan recommended the reintroduction of rates on domestic property to replace "the accumulation of ad hoc charges and taxes" (including the residential property tax).

local authorities with greater discretion devolving to local authorities to determine their overall spending levels.

25. This restructuring would involve replacing, in whole or in part, the existing grants in relief of domestic and agricultural rates provided by central Government. The Council however, would still see the need for a central Government grant as an equalisation instrument between local authorities. This grant would compensate those local authorities with a below average revenue base and/or an above average spending need. Finally, the Council would envisage the central Government financing any national services provided by local authorities on its behalf.

26. Having examined the appropriate financing mix and having recommended a property tax as part of that mix the next section considers the precise form of property tax. This is done under a number of headings, adhering closely to those used by the consultants: coverage; the tax base and valuation procedure; rebates on residential dwellings; and relationship with other taxes.

Coverage of a Property Tax

27. While the Council agrees in principle with the notion of a property tax, the precise coverage of the tax did not command consensus. Some members of the Council argued, in line with the consultants, that the property tax should be comprehensive, applying to all immovable property. Others argued that farmland should be exempt from the property tax on the basis that it is different in nature from private residences. This distinction was drawn primarily on the basis of the use to which various properties are put with the latter group arguing that farmland constitutes a means of production and is therefore not a suitable base for taxation.

28. The consultants welcome the farm tax as proposed in the National Plan because of its recognition of the need for a stronger local tax base. However, to the extent that the tax will be set by central Government and will replace some or all of the rate relief grants at present provided by central Government, the farm tax does nothing to increase the powers of local Government to determine its level of spending (a point which the consultants acknowledge). The consultants also welcome the proposed farm tax for its effect of widening the base of property taxation. However, they express some reservations regarding the valuation procedure (acreage adjusted for productivity), in particular, on the grounds that it might impede the further extension of property tax.

29. The Council's views on the proposed farm tax were set out in NESC Report No. 79. The Council was critical of the proposed tax arguing that it appeared to represent an amalgam of income tax and resource tax with no explicit differentiation between the two. The Council in that report expressed itself in favour of the taxation of farm profits on the basis of income and believed that any question of a resource tax should be an issue of development policy.¹

30. If the logic of the argument against the taxation of farmland is accepted, then it becomes quite difficult to sustain the argument that commercial and industrial property should be subject to a property tax. A property tax on both commercial and industrial property and farmland is sometimes argued for on the basis of the need for a contribution from these sources towards the provision of those local services from which they benefit and for which charges are not appropriate. This would involve a departure from the concept of ability to pay; a principle on which taxation systems generally tend to rest.

31. The case for a property tax on domestic dwellings can be made on the basis of an "imputed rent" argument.² The Commission on Taxation argued that in order to achieve equity between owners and renters of housing the most satisfactory method, in principle, is to charge to tax the excess of notional income arising from the occupation of housing over any rent paid. Under this mechanism the owner of a house would be allowed to set against his liability to tax on the annual value of the house, the interest on any mortgage or other debt incurred for the purchase of the house. However, the Commission argued that it would be difficult to obtain general acceptance for the taxation of imputed income and also that there would be significant difficulties in introducing such a scheme. They did not therefore recommend that the imputed income from housing be taxed, except in the case of second houses. Rather the Commission recommended the abolition of the general tax relief in respect of mortgage interest and its replacement by a scheme which would confine interest relief to the first five years of home ownership.

32. An alternative method of taxing the imputed income from housing

¹The Commission on Taxation argued that "provided all farmers are liable for income tax there is no case in principle for imposing rates on land".

²The imputed rent is a measure of the benefits a person receives from owning a dwelling. The case for taxation of imputed rent rests on the favoured treatment of house owners relative to those renting accommodation. Mortgage interest tax relief was originally introduced at a time when imputed income was taxed, so as to avoid double taxation.

is through a property tax. There is at present a national residential property tax which the consultants recommend should be replaced by a new property tax. The national residential property tax is levied at 1½% on that portion of the market value of domestic property in excess of £65,000. There is also an income threshold of £20,000 indexed on an annual basis below which the tax is not payable; (these thresholds refer to 1983/84); This tax has been described as cumbersome and expensive, requiring a lot of administrative time and effort to collect trivial amounts of revenue. It has also been criticised on the grounds that it grafts a property tax onto a definition of income which is defective and does not apply equally to all persons.¹

33. The introduction of a local residential property tax can be viewed as either the abolition of the national property tax and its replacement by a local residential property tax or the introduction of significant modifications to the national residential property tax. These modifications would include the removal of income and capital value thresholds. Any further necessary modifications are evident from the remainder of this section.

The Tax Base and Valuation Procedure

34. Having reviewed the case for basing a property tax on capital and rental values, the consultants recommend a system based on capital values. The consultants recommend that valuation should be based on market sales, relying initially on a degree of self-assessment with market values being fed into the system as they became available.

35. The Council agrees with the consultants that a property tax should be based on capital values, initially self-assessed but gradually moving towards market values. Where market values are used there should be provision for appeals.

Rebates

36. In order to avoid the difficulties which arose with the domestic rating system up to 1978 the Council agrees with the consultants that the residential dwelling element of the property tax should be accompanied by an effective rebate system. The suggested major characteristics of the system are as follows:

- (i) the rebate should be linked to the payer's income and tax payable;
- (ii) the rebate scheme should have a redistributive rationale;

¹Address of the Chairman of the Commission on Taxation to the Society of Chartered Surveyors in Ireland, 7 March 1985.

- (iii) the scheme should be determined and implemented in the context of overall national policies on tax and benefits;
- (iv) the scheme should be on a sliding scale to prevent the emergence of poverty and unemployment traps.

The Council considers that any rebate scheme should be determined on the basis of national uniform criteria.

Relationship With Other Taxes

37. The relationship of the proposed property tax to other taxes and to the overall taxation system is of crucial importance. This is because of the way in which the system of local and national taxation evolved since the late 1970s. The transfer of responsibility for domestic rates from domestic ratepayers to central Government may have led to the belief that domestic ratepayers were better off to that extent. However, national taxation subsequently grew rapidly, partly to finance the grant paid to local authorities in relief of domestic rates. The subsequent squeeze on this grant and the introduction of charges have led some local authority consumers to believe that they were "paying on the double" for local authority services. Against this background there is a danger that the introduction of a local domestic property tax, unless accompanied by a very visible reduction in other forms of taxation, would face quite significant resistance.

38. In undertaking this study the Council was very conscious of the constraints on any increase in the overall burden of taxation. It, therefore, envisaged that any recommendations on additional taxes must be offset by equivalent reductions in other taxes. In the context of local authorities being empowered to levy property taxes, the Council would so recommend only on condition that national taxes be reduced by the amount of the net yield from property taxation. The consultants examined a number of ways by which this reduction might be effected and the trade-offs between issues of principle and presentation. If a domestic property tax is *credited* against income tax then *income tax liability is reduced* by the amount of the property tax. In this case the burden on the income tax payer is zero and the income tax receipts of central Government decline by the amount of the property tax. This system however, fails totally on the accountability criterion. In addition, in order to protect the Exchequer, the central Government would be obliged to intervene to control the loss of its revenue, thus reducing the discretion of local authorities to determine their spending levels. On the other hand *allowing* it against income tax *reduces* a taxpayer's *income assessable for tax* by that amount. The effective burden on the taxpayer and the loss to the Exchequer then depends upon the tax-

payer's marginal tax rate. For this same reason accountability is again blurred and central Government would be likely to place some controls on the rate at which the property tax was levied. In addition to these considerations the property tax would bear more heavily on those who pay no income tax if it was made allowable. It would also run counter to the generally accepted objective of simplifying the income tax structure.

39. The only argument in favour of making a domestic property tax allowable is that there is a consequent visible reduction in income tax. It could be argued that this would increase the public acceptance of such a property tax. However, there is no justification in principle for making it allowable any more than there is for making any other tax allowable. In the light of this and the considerations of the previous paragraph the Council is not in favour of making it allowable against income tax. However, the Council believes that the cut in State grants to local authorities and the consequent reduction in national tax subsequent to the introduction of a property tax should be highlighted in the arguments in favour of such a property tax.

Concluding Remarks

40. Having expressed the view that an independent source of revenue is an essential feature of local Government, the Council believes that a system based on a local property tax is the most practicable method of giving local authorities a satisfactory source of local revenue. While the Council is in principle in favour of a property tax, there is some disagreement on the precise coverage of the tax, in particular, with regard to the inclusion of farmland.¹⁺² The Council believes that the tax should be initially based on self-assessed capital values subject to audit by the individual local authorities. The Council also recommends that market values should be used as they become available, with provision for appeal. The Council also believes that an effective rebate scheme for domestic property tax payers should be introduced as outlined above. The Council believes that a property tax on commercial and industrial property and, subject to the above reservation, on farmland, should be treated, as appropriate, as an expense in arriving at income for tax purposes or as a tax credit. The Council recommends that property

¹The agreement of the ICTU is subject to the property tax being applicable, as recommended by the consultants, to all property including farmland.

²The IFA is strongly of the view that farm land constitutes the basis of production in agriculture and therefore cannot be subjected to a property tax. Farm land has a very high capital value relative to its income yield. A property tax on farm land would have to be paid out of income and would clearly discriminate against farmers who require large amounts of capital in the form of farm land just to produce an average income.

tax paid on residential property should not be allowed against income tax payable.³ The Council, recommends, that national taxation should be reduced by the amount of the net yield from property taxation and that this reduction should be clearly demonstrated.

41. With the introduction of a local property tax the Council would envisage central Government grants to local authorities being reduced by an amount equivalent to that raised by the property tax. The Council would still see a need for central Government grants, however. They would serve two functions: (i) equalisation, i.e. to compensate authorities with a low tax base or high spending needs; (ii) to finance national services provided by local authorities on behalf of central Government.

42. In the absence of movement towards restoring the power to determine their own spending levels to local authorities the Council believes that funds from central Government be provided in the form of specific grants covering national services together with a block grant to cover other activities of local authorities.

³This is contingent upon mortgage interest continuing to be allowable for income tax purposes.

APPENDIX I

COMPOSITION OF STEERING GROUP

Mr G. Tierney, Chairman

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Irish Co-operative Organisation Society

Mr T. O'Connor

Public Expenditure Division
Department of Finance

Mr J. Cullen

Local Authority Finance Division
Department of the Environment

Mr P. Murphy

Irish Congress of Trade Unions
Member of the National Economic and Social Council

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Limerick County Council
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City Manager
Limerick Corporation
(Nominee of County and City Managers' Association)

Mr C. Power

Director of Economic Policy
Confederation of Irish Industry
Member of the National Economic and Social Council

Mr J. Doherty

Central Bank of Ireland

Mr G. Danaher

Secretary to the NESC was Secretary to the Group.

PART II

THE FINANCING OF LOCAL AUTHORITIES

by

C. Foster
R. Jackman
Q. Thompson

THE FINANCING OF LOCAL AUTHORITIES

Summary and Conclusions

1. The present arrangements for financing local authorities owe much to past expediency but little to reason. They are the product of a series of piecemeal and often ill-considered decisions. The result is a system in which the local tax base has no electoral franchise, in which authorities levy local charges but by a method which resembles taxation, and in which the bulk of the revenue is supplied by Government but distributed on a basis that is no longer acceptable as a base for raising revenue.
2. At the same time, tax burdens in relation to income are high – both for indirect and direct taxes. Furthermore, compared with other countries, Ireland has a narrow tax base which results in high rates of tax even for those on fairly modest incomes. There would be major advantages in finding a way forward for local government finance which also helped widen the base of the tax system.
3. The basic question is the following: Should local authorities have restored to them the discretion to determine their overall levels of expenditure, or should they instead lose that discretion?
4. To be able to exercise such discretion is not a *sine qua non* for local government – local authorities in The Netherlands have virtually no such discretion at present; in effect that was also the position in Ireland between 1978 and 1982. Under such a system, local authorities would be funded by grant from central government – although with some scope for raising charges – and would have no access to a local tax source. Were such a system to be introduced in Ireland, it would be appropriate for the rates on industrial and commercial property to be set nationally.
5. Under these arrangements local government finance would consist of a series of specific grants for national services (such as national roads) together with a single block grant for the others. The block grant would be determined by reference to a few simple indicators, as in The Netherlands. Authorities would have discretion over the way the funds were spent, for which they would be answerable to the local electorate. Over the past 6-8 years, the changes in local government finance in Ireland have tended in this direction. We consider it perfectly

feasible to adopt such a system, if it were thought to be politically acceptable, though in our view it would require a radical restructuring of the present grant system.

6. However, this has not been the traditional approach to local government in Ireland — although the break with tradition was first made in 1978. Nor would it, of itself, help to widen the tax base. But to restore the traditional level of discretion to local authorities would require them to have a local source of revenue sufficient to form a significant part of their resources. This revenue should be raised from the electorate to whom they are electorally responsible.

7. We first examined the scope for charges to provide the major local source of revenue. We make a number of suggestions for changes in the charging arrangements (including the possibility of water metering, a local car tax and a more reasonable basis for calculating housing rents — see Chapter 3). But we do not think that charges alone could provide the major source of revenue for local authorities.

8. We therefore explored other ways of raising revenue at the local level. We briefly considered the possibilities of a payroll tax, a poll tax, taxes on lotteries and gaming and an assigned revenue for central government. For various reasons (see Chapter 2) we rejected each of these as major contributors to local government finance. We focussed therefore on three main options: a local sales tax, a local income tax and a new form of property tax. We examine these three in Chapter 4.

9. The form of any local sales tax (set and raised locally) would be subject to European Community constraints, there would be the administrative complexity of grafting another layer on to a six level VAT system, but, perhaps most fundamentally, the tax fails the criterion of accountability. We also had doubts about a locally set income tax; this is in part due to the administrative difficulties of adding such a tax on to a national tax system based on income flow. If there were major changes in either VAT or income tax, then local sales or income taxes might be more feasible. However, in neither case would such a tax widen the country's tax base and would thus do little or nothing to assist with the present serious fiscal problems (discussed in Chapter 1).

10. We examined at some length the idea of a new local property tax. We concluded that it would be possible to devise such a tax which would avoid the shortcomings of the previous domestic rating system. It would consist of a tax on all land (including agricultural land) and

local valuers or by using an index to update the actual purchase price it would be essential to have a comprehensive rebate system linked to income levels with a sliding scale; this should be centrally determined and funded, but locally administered.

11. If there is a wish to restore the traditional level of discretion to local authorities, rather than to move to a more centrally based system, then we think that such a form of property tax offers the best way forward. It would enable local accountability to be enhanced, would be administratively feasible and would have the major advantage of widening the national tax base and thus enabling other, national, taxes to be lowered, although we see presentational advantages in allowing this tax against income tax, there would also be disadvantages, for example such arrangements would be of most benefit to those who paid higher levels of income tax.

12. Since undertaking this work the Government has proposed a new Farm Tax: the details of its operation are not yet clear. Insofar as this is a recognition of the need for a stronger local tax base and for its effect of widening property taxes, we think this is to be given a cautious welcome. However it is only a small step and there is a risk that, if centrally set, the tax will merely provide local authorities with one centrally determined block of funds in place of another — the grant in relief of rates on agricultural land.

13. Even with a major source of local revenue, local authorities would still need to receive grants from central government for two reasons. First, some of the services are national ones (e.g. national roads) and so should be the subject of specific grants. Second, there would be a need for grants to authorities to achieve a degree of equalisation (or equity) in order to allow for the fact that some authorities will have spending needs which are high (in relative terms) compared with their local taxable resources.

14. In summary, then, we think that the financing of local government stands at a watershed. Without change there is likely to be further escalation of what are already serious financing difficulties for local government as a whole. A clear political decision is needed to determine which way it is to move: to a system which is based primarily on central government grants, as in The Netherlands, or to a system relying on a substantial base of local revenue as has been traditional in Ireland. To move to either option will require decisions which will be difficult in the short term. The present arrangement attempts to straddle the two; in our view, it fails.

CHAPTER 1

THE BACKGROUND

The Macro-economic Context

1.1 The finances of local authorities form part of the public sector: they affect the overall tax burden in the economy, its distribution across people and enterprises, the public sector's overall claim on economic resources and the volume of public debt. Any proposals relating to local authority finance must be judged at least in part with regard to their impact on public sector financial management in the economy as a whole.

1.2 Total public expenditure as a proportion of GDP is significantly higher in Ireland than in most other European countries although until recently the total tax burden was close to the European average. As a result there was, for many years, a large budget deficit, and indeed it appears that, as a proportion of GDP, it was the highest in Europe by quite a large margin. The OECD National Accounts provide a consistent basis for comparison; the most recent year for which comparative figures are available is 1981. These figures are set out in Table 1, and summarised below:

	<i>Ireland</i>	<i>European average</i>
Government spending as % of GDP	51.1	48.3
Tax revenues as % of GDP	42.3	44.0
Budget deficit as % of GDP	8.8	4.3

1.3 As a result of running a large budget deficit for a number of years, the debt of the Irish Government has risen rapidly. In recent years, the bulk of the deficit has been financed externally. By 1983, the national debt stood at over 100% of GDP, externally held public sector debt stood at 62% of GDP and the annual cost of interest payments on the external debt alone amounted to over 15% of GDP.

1.4 The impact of such high levels of debt on domestic taxation and interest rates has led the Government to adopt more restrictive fiscal policies, with the original objective of eliminating the current budget

deficit by 1987. Restrictive fiscal measures were introduced in 1981 and 1982, and the 1983 budget was marked by exceptionally sharp tax increases. In the short run, the tax increases have further depressed economic activity thereby reducing tax yields; hence the improvement in the "underlying" or "structural" deficit has been in part masked by a deterioration in the "cyclical" component. There would seem to be bi-partisan support for the objective of reducing the budget deficit; furthermore we found considerable support for this, and its consequences, at local government level too. Thus it seems reasonable to assume that overall fiscal policy will continue to be restrictive in the medium term and that this will continue to form an important influence on solutions to the problems of local authority finance. Most recently, in the autumn 1984 Plan "Building on Reality 1985-87" the Government has reiterated its determination to "halt the spiral of debt and debt-servicing costs" (para 1.17). Though the target of eliminating the current budget deficit by 1987 is no longer considered feasible, the Plan stresses the need for further reductions in the size of the deficit (chapter 7).

1.5 Turning from the overall budgetary position to taxation, OECD Revenue Statistics for 1982 show the total tax burden in Ireland very close to the European average.¹ It cannot be assumed even at that time however, that Ireland was not a heavily taxed country. In general, taxes can be raised more easily in countries where GDP per head is high than in countries with a lower GDP per head. Chart 1 relates tax burdens (i.e. taxation as a percentage of GDP) to per capita GDP for 16 European countries in 1982. The dotted line shows the tendency for wealthier countries to be able to afford higher tax burdens. As can be seen, Ireland is a long way above that line, suggesting that, in relation to incomes, tax burdens were already very high. While many European countries have heavier tax burdens, most such countries have per capita GDP very much greater than that of Ireland. Since 1982, as already noted, tax burdens have significantly increased, putting Ireland even further out of line.

1.6 The distribution of taxation between different types of tax in 1982 is shown in Charts II and III. Ireland has a relatively heavy dependence on indirect taxes and makes relatively little use of "other taxes" (i.e. taxes other than taxes on incomes, indirect taxes and social security

¹The figure given for tax revenue as a proportion of GDP for Ireland in 1982 in OECD Revenue statistics of 39.6% has subsequently been revised to 37.9%. The equivalent European average was 38.3%.

taxes). In 1982, Ireland raised 46% of its total taxation from taxes on goods and services, the highest of any OECD country, and compared with a European average of just over 30%. In 1982, the bulk of this indirect tax revenue came from customs and excise duties rather than from general taxes on consumption (such as VAT). Customs and excise duties then constituted over 25% of Irish tax revenue, which was almost twice the European average. In the last few years, VAT has been substantially increased so that it now raises more than half the total indirect tax revenue.

1.7 Direct taxes (that is taxes on incomes, profits and capital gains) in Ireland yield about 35% of total revenue which is close to the European average. Within this total, taxes on corporate income are relatively low (4.7% of total tax income in Ireland as against a European average of 6.9%). Turning to personal income tax, there are several sections of the population who are able to take advantage of the wide range of exemptions and allowances in the income tax system to pay little or no income tax with a consequently higher burden on those who do – primarily those subject to PAYE. An OECD report on "Income Tax Schedules: Distribution of Taxpayers and Revenues" published in 1981 found that in Ireland 20 people in every 100 were tax payers. By comparison, in other countries with similar income tax systems (taking the family as a single tax unit), the figures were: Belgium 32, France 26, Germany 33, Italy 38, Norway 35 and the UK 36. Although much of this difference can no doubt be accounted for by differences in average family size, or other demographic factors such as the age distribution of the population, it still suggests a low income tax coverage in Ireland.

1.8 The same study also showed that the marginal tax rate facing the median taxpayer was higher in Ireland than in any other European country except Belgium, although if local income taxes are also taken into account, the Scandinavian countries have higher marginal tax rates than Ireland. But since that time, income tax burdens in Ireland have risen substantially, particularly as a result of the 1983 budget. It is estimated that, after the 1983 budget, no less than 40% of taxpayers faced a marginal income tax rate of 45% or above. By comparison, ten years ago only 1% of taxpayers were in this position. A single person on average industrial earnings now faces a marginal tax rate of 63.5% (inclusive of Pay-Related Social Insurance contribution). Because of exemptions and allowances, average tax rates are much lower, but there can be no doubt that the high marginal rates impose a heavy cost, as the Commission on Taxation has pointed out, in terms of the perceived inequity and inefficiency of the overall tax system.

1.9 Turning to taxes on capital and property, in 1982 such taxes provided 3.7% of total tax revenue, which is again close to the European average. About one third of this was from stamp duties. The yield from estate duties in Ireland is minimal. Rates themselves contributed the remainder of the revenue in this category, about 2.2% of total tax revenue in 1982, a figure which had decreased from 4.7% in 1978. Again, however, the property tax base in Ireland is much narrower than in most countries because of the abolition of domestic rates.

1.10 This brief survey of the macro-economic context leads to the conclusion that a major objective of fiscal policy must be to attempt to widen the tax base. The Government has set itself the objective of a substantial reduction in the budget deficit. While in principle a very substantial reduction in public expenditure could both eliminate the budget deficit on current account and permit a reduction in taxation, in practice it seems to be recognised that a reduction on this scale will be difficult to obtain; even if it were, improvements in the tax structure would still be highly desirable. More realistically, it appears unlikely to be feasible to reduce the overall tax burden in the medium term.

1.11 There are thus clear advantages in widening the base of the tax system to relieve the pressure on the most heavily burdened taxpayers. These advantages have been recognised by the Commission on Taxation with regard to income tax and by the National Planning Board. In the 1984 budget the Government set itself the objective of restoring the tax base by reducing allowances, reliefs and deductions. The purpose of such a widening of the tax base must be one of reallocating the existing tax burden rather than permitting an increase in overall tax revenue.

1.12 In the context of local authority finance, it is necessary to recognise that any proposal for financing local government spending affects the overall tax burden in the economy. A proposal for local authority finance which assists the achievement of overall fiscal objectives may therefore be regarded as more helpful than one which makes the existing imbalance worse. In what follows we will not rule out options on such grounds; nevertheless, in weighing the merits of alternative options, their impact on the Government's overall economic strategy should be taken into account.

Local Government Finance: the European Context

1.13 In any comparison with other European countries it is apparent that Ireland has far fewer functions which are the responsibility of local government (or regional government in those countries which have

a regional tier). Table 2 shows the allocation of functions to local and regional authorities in EEC countries (except Greece) in 1978. Ireland is the only country in the EEC in which local authorities are not responsible for education or for welfare services – two of the largest services in terms of expenditure in most countries. Thus total local authority expenditure as a proportion of public expenditure or of GDP is low compared with other European countries.

1.14 Turning from expenditure to finance, as shown in Chart III, Ireland is the only country in Europe, with the exception of the UK, in which local government is confined to a single source of taxation, namely local property taxes (rates). In recent years this source of local tax revenue has been further reduced since domestic rates have ceased to be a locally paid tax, and by the ending of rates on agricultural land. Local authorities are thus now confined to an exceptionally narrow tax base: the assessed rental value of commercial, industrial and other non-domestic property.

1.15 At present, local authorities raise about 12% of their current expenditure from local taxation. Comparable figures for other countries for 1983-84 are not readily available. In Table 3, sources of local finance for the EEC countries (except Greece) are given for 1978. In most countries around 30-40% of local expenditure is financed from local taxes. However, the present Irish level of 12% is not an isolated extreme; in The Netherlands less than 6% of current expenditure is financed from local taxation. The Netherlands indicates the possibility of a viable system of local government based almost entirely on grant finance.

1.16 In terms of composition of local revenues, The Netherlands is perhaps closest to the present position in Ireland, and we will refer again to it in more detail in subsequent chapters. While it is also true that in Italy only about 10% of local expenditure is financed from local taxation, a comparison with Italy is rather misleading because in Italy local authorities supply, and charge for, electricity. If charges are removed, the ratio of local taxes to state transfers (grants) in Italy is significantly higher than in Ireland.

1.17 Local authorities now receive 65% of their current income from central government grants. Again, comparison with other countries in Table 3 shows that 65% is a high figure but not exceptionally so. The grant proportion in The Netherlands is close to 80%; in Belgium and in the UK (in 1978) the grant proportion came close to 60%. The other main source of finance is other income and in particular that from charges. In 1983, Irish local authorities received 23% of their

income from these sources which is relatively high by European standards (particularly after allowing for the electricity factor in Italy). However, about 31% of this income consists of home loan repayments, 4% is for pension contributions and nearly 7% is for the provision of agency services for other bodies. It could be argued that the functional responsibilities of local government in Ireland are well suited to charging: we pursue this point in more detail in Chapter 3.

Recent Developments in Irish Local Finance

1.18 In common with many European countries, Ireland has experienced a rapid growth in public expenditure relative to GDP since the early 1960s. On OECD definitions, total Government outlays as a proportion of GDP rose from 29.7% in 1961 to 33.1% by 1965, 39.6% by 1970, 47.4% by 1975 and 54.5% by 1980. This growth in expenditure has been accompanied by growth, albeit at a slower rate, in taxes as a percentage of GDP. Again on OECD definitions, the proportion increased from 25.7% in 1961 to 27.9% in 1965, 35.3% in 1970, 35.2% in 1975 and 41.7% in 1980.

1.19 In contrast to the general increase in taxation, rates as a proportion of GDP, and domestic rates as a proportion of personal disposable income, remained fairly stable up until the mid 1970s. Figures quoted by Copeland and Walsh in their 1975 study for the Economic and Social Research Institute ("Economic Aspects of Local Authority Expenditure and Finance", Table 4.8, p. 67) show rates (i.e. domestic and non-domestic rates) close to 3% of GNP from the early 1950s up to 1972. There was then a sharp fall to 2.1% by 1974 in part due to the removal of health and of some housing costs from rates; there was also a "short" nine months year in 1974. By 1976 the proportion was back to 3%.

1.20 The political pressure which led to the abolition of domestic rates in 1977 (or, more accurately, to their transfer to central government) arose for a number of reasons. First, rate bills had fallen sharply in real terms in 1974 in part because prices had risen unexpectedly fast and in part for the reasons given in the previous paragraph. With inflation continuing in 1975 and 1976, very large increases in rate bills (in money terms) in those two years were necessary simply to restore and maintain the historically normal relationship of rates to GNP. Second, with the overall burden of taxation rising, rates as a particularly visible tax which required specific payments to be made in lump sums by the ratepayers may have become a convenient form of taxpayer resistance even though the burden of other (less visible) taxes was rising more rapidly. Third, for a number of reasons, due primarily to the antiquated valu-

ation system but also to the absence of equalisation grants, rates had come to bear little relationship to the ratepayer's ability to pay. While this last factor had been a long-standing problem of the rating system, the inequity of rates in conjunction with inflation and high taxation generally had become politically unacceptable.

1.21 From the viewpoint of local authority finances, however, domestic rates were not so much abolished as the liability for paying them transferred from the ratepayers to central government. The Government instituted a new grant, the grant in relief of domestic rates, originally intended to compensate local authorities in full for their loss of domestic rate income. Thus, after the abolition of domestic rates, local authorities continued to set rate poundages which determined their rate demand on non-domestic and agricultural ratepayers, and received a grant from central government equal to the product of the rate poundage and the total rateable value of dwellings within the local authority.

1.22 An immediate difficulty with this arrangement was that it would have given local authorities the opportunity to determine their grant entitlements. The higher the rate poundage they set, the more grant in relief of rates they would receive. Therefore, to protect both the central government budget and the remaining non-domestic ratepayers, the Government also introduced a control on the extent to which local authorities could increase their rate poundage. In 1978 the maximum permissible rate increase was 11%, in 1979 10%, in 1980 10%, in 1981 12% and in 1982 15%.

1.23 Over this five year period local authority revenues from rates and grants in relief of rates would thus have risen, in the absence of any changes in rateable value, by a maximum of 73%. In practice, the increase in revenue was higher than this because the growth of rateable value provided a buoyancy to the tax base of just under 3% per annum. Hence potential rate income rose by nearly 98% over the period, although the withholding of some IR£15m rates by farmers in 1982 reduced the increase in practice to about 90%. Over the same five years, prices rose by 103% so that local authority revenues at the end of the period were, in real terms, about 6% lower than at the beginning. Since 1982, the notional rate on dwellings has effectively been "decoupled" from the non-domestic rate. Local authorities are now free to determine the rate on non-domestic property. At the same time, the domestic rate relief grant was raised by 18.5% in 1983 but increased by only 0.8% in 1984.

1.24 As a result, local authority income has been very severely con-

strained and, in 1983, legislation was introduced to widen the powers of local authorities to levy direct charges for services. The 1983 Act gives in effect a general power for local authorities to charge for services they provide "to any person or in respect of any premises", revoking any previous statutory prohibitions or limitations on charging. The intention was to make authorities free to charge for whatever services they wish; the phrase in quotation marks above being construed only as a limitation to services where there are identifiable and separate benefits to individuals or households rather than services providing a collective benefit to the community as a whole. The expectation was that local authorities would be likely to introduce (or increase) charges for water, waste disposal and the like. The legislation did not, however, allow local authorities to determine the price for their most tradable service, housing (see Chapter 3).

1.25 There appears, however, to have been considerable resistance on the part of consumers to paying the new water charges in urban areas. It has, for example, been estimated that for those local authorities and corporations raising new charges in 1983, only about 10-15% had been collected by the end of the year: even of the total charges due (around IR£20m), only about IR£9m had been collected. However, several authorities stressed to us that they did not send their demands out until late in the year and that they are expecting the final collection proceeds to be much higher. Even so, it appears unlikely that anything like the full amount will be collected. We gather that only about a third of the new charges due had been collected by the end of March 1984, although for total charges the figure had reached over 60%.

1.26 The resistance to the new charges stems from a number of causes, one of which is the view that charges for public services are simply a form of taxation, and that the overall level of taxation is already excessive. When domestic rates were abolished/transferred, income tax was increased to meet the revenue shortfall and thus to cover the costs of services previously financed from rates — such as water, at least in the urban areas. It was apparent from our discussions that many people consider that to levy water charges now, on top of the higher taxes, is to charge twice for the same service (see Chapter 3). Water charges are a visible payment which, like domestic rates, actually have to be collected from the householder (rather than deducted at source) and which hence provide a natural and convenient mechanism for taxpayer protest, even though the water charge itself is not necessarily excessive in relation to the cost of the service provided.

1.27 Developments with regard to agricultural rates were somewhat

different. For a long time, farmers enjoyed the benefit of partial remission of rates. In 1978, those farm buildings not previously derated were then derated along with household dwellings. In 1981 a further relief was given in that small landholders (total rateable value IR£50 or less) were exempted from rates. Finally, in 1982, the High Court ruled that the basis of valuation for agricultural rates was unconstitutional; in 1984 the Supreme Court upheld the contention that it was unconstitutional to levy taxation on a basis which was as inequitable as agricultural valuations had become. Hence farmers are no longer liable to rates; revenue from agricultural rates had in fact started to decline in 1982 as some farmers had started to withhold payment in anticipation of the High Court judgement.

1.28 The major consequence of these developments on domestic and agricultural rates has of course been a sharp reduction in the proportion of local government current account revenue deriving from local taxation. As shown in Table 4, that proportion has fallen from just over 40% in 1976 to just over 12% in 1984. The loss of rate income has been made up almost entirely by Government grant, the share of which has risen from 38% in 1976 to 64% in 1984. There has been no significant increase in the proportion of expenditure financed through charges, although the effect of the 1983 legislation has not yet had time to work itself through to full implementation; several authorities are seriously considering ways in which the scope for charging for services can be increased.

1.29 Government grants to local authorities take two forms:

- (a) rate deficiency grants – the agricultural grant and the grant in relief of domestic rates. These are general grants, unrelated to expenditure on particular services, which serve to compensate local authorities for rate reliefs granted by central government to farmers and domestic ratepayers.
- (b) specific grants – tied to specific items of expenditure. At present there are 100% specific grants on loan charges incurred on local authority housing and for local authority expenditure on maintenance and improvement of national roads; there are also matching grants at a lower rate, normally between 40 to 60%, for loan charges incurred on sanitary services, swimming pools, libraries, fire stations, etc. In addition there are (non-matching) general grants towards the improvement of local roads.

1.30 As compared with grant systems in many European countries,

the Irish grant system is unusual in that it does not recognise differences in the circumstances of local authorities which can affect their need for public services nor differences in the costs of providing them (except crudely in the variation in the grant percentages for sanitary services). In many countries grant systems attempt to provide additional assistance for local authorities where spending needs are high. It is also common in many countries to provide grants to supplement local taxation in areas where the local tax base is low. Such considerations appear absent from the Irish system except to the extent to which central government directs capital allocations – which attract the bulk of specific grants – to the most needy areas. This may be a less serious shortcoming in Ireland than it would be elsewhere; we examine, in Chapter 5, the operation of the grant system and the case for its reform.

1.31 Turning from finance to expenditure, in Table 5 recent trends in local government spending are set out in the context of developments in the economy as a whole. In money terms, local authority expenditure, both current and capital, has been growing quite rapidly since 1976, although as a proportion of total public expenditure it has remained relatively static, falling from 15.6% in 1976 to 13.4% in 1982. Over the same period, however, local authority expenditure has increased perceptibly in relation to GNP. We have already noted the rapid growth in public expenditure over the last few years. While local government spending has clearly contributed to this growth it has by no means been the major contributor. From 1976 to 1981, local authority expenditure overall, taking current and capital together, rose by just over 40% in real terms, while over the same period total public expenditure rose by over 44%, central government expenditure on health increased by 58% and on education by 35%.

1.32 Part B of Table 5 converts the expenditure figures into real terms allowing for changes in the value of money. (In economic terms these figures are in "cost" rather than in "volume" terms, that is to say they are cash figures deflated by a general price index rather than by the specific prices of goods and services purchased by local authorities). The table shows a sharp decline in the growth of current expenditure of local authorities around 1980, as a result of the limitation on the funds available to them. By contrast, capital expenditure continued to grow quite rapidly up to 1982.

1.33 The services provided by local authorities are classified into eight programme groups. The gross and net current expenditure on each programme group is shown in Table 6. Net expenditure is expenditure

net of both user charges and specific government grants: it is the money the local authority has to find from rates and rate deficiency grants. While programme group 1 (housing) features prominently in gross expenditure, the bulk of local government spending on housing is met by specific grants and by rents, so that net expenditure is small. The other main local government services – roads, water and sewerage and environmental protection – form a large part both of gross and of net expenditure.

1.34 Current expenditure on programme groups in real terms is set out in Table 7. The final column of part A of the table shows the growth in expenditure in real terms within each programme group over the six years 1976 to 1982. All services show a substantial expansion with the exception only of programme group 7 (which consists largely of payments to other bodies and other statutory obligations). As indicated earlier, the most rapid expansion occurred before 1980. Between 1976 and 1979 gross expenditure increased by 25.9% as against an increase of 8.3% between 1979 and 1982.

1.35 It is interesting to compare this last figure with the overall growth of current net expenditure over the period, shown in part B of Table 7. While gross expenditure has increased by 8.3%, net expenditure has declined (as might be expected as a result of the limitation on rates) by 7.1%. The difference has been made up of specific grants and charges. On the basis of the figures in Table 4 for overall receipts from charges, it is possible to separate out these two components, and this is done in Table 8. It appears that, over the last four years, while the Government has been holding down the general income of local authorities through rate limitation, it has permitted growth in local expenditure to continue by means of a rapid increase in specific grants.

1.36 The growth in specific grants is, of course, in part attributable to the continuing high level of capital expenditure (shown in Table 5). Given that capital expenditure is controlled by central government through a system of capital allocations, it is reasonable to ask why capital expenditure has been allowed to continue to grow while current expenditure is being held back. One reason is that the impact of the current recession is said to have been exceptionally severe on the construction industry and a more lenient treatment of capital expenditure appears to have been in accordance with Government policy objectives. At the same time it must be noted that this had the effect of adding to the public sector borrowing requirement at a time when Government policy was committed to its reduction.

1.37 One of the major implications of these developments is that the discretion of local authorities has been severely curtailed. In many cases their current income is scarcely sufficient to meet already committed expenditures, while their capital expenditure, which is funded almost entirely by loans from central government, is subject to the decisions of central government. But the political context in which local government operates has remained unchanged: local politicians fight elections seemingly on the same basis as before, and yet, once elected, have few options because of the financial constraints they face. In such circumstances it can only be expected that local politicians will devote much of their time to attempting to extract more funds from central government, particularly given that the costs of local expenditure projects and services no longer fall on the local resident.

1.38 In The Netherlands, local authorities have only very limited sources of independent finance, and their discretion is limited to allocating a more or less fixed budget between different services. Clearly, a similar structure could operate in Ireland if this were the political wish. But the limitation of the discretion of local authorities in Ireland appears to have taken place more as the unintended consequence of measures, such as the abolition of domestic rates, introduced for other reasons, rather than as a deliberate act of policy.

1.39 But if local authorities are to retain their traditional political powers and responsibilities and the ability to determine their own overall spending levels, it is necessary for financial accountability that they should have an independent source of revenue derived from those to whom they are electorally accountable. At present local authorities are confined to a source of taxation which does not bear generally on local residents, that is non-domestic rates. We discuss the principles involved, and their implications, in the next chapter.

CHAPTER 2

BASIC PRINCIPLES

Introduction

2.1 A guiding principle for any system of government is that those having final responsibility for determining the level of public expenditure should also be responsible for raising the tax revenues to pay for it. Only then can the benefits to the community of a particular item of public expenditure be properly weighed against the costs, which may be a higher *overall* tax burden or spending cuts in other areas. The pressures for growth in public expenditure – sometimes as much from those involved in providing the service as from those for whose benefit the service is being provided – are always present. The proper counterweight to such pressures is the pressure to hold down taxation, and it is for this reason that decisions on expenditure and on the raising of taxation must go together.

2.2 In a democratic system, politicians responsible for decisions on public expenditure will be answerable for their decisions to the electorate. It follows that the taxes they levy to pay for public expenditure should be raised from the same electorate to whom they are electorally accountable. Furthermore, to be effective the distribution of responsibilities must be clear not only to those wielding them but also to the electorate to whom they are answerable. This guiding principle is that of accountability: that authorities which levy taxes can be held accountable to the people from whom the taxes are raised both for the amount raised and for the way in which the tax revenues are spent.

2.3 In principle, one could imagine a situation in which local authorities were completely free standing organisations: free to levy whatever taxes they wished on their local residents and to spend what they liked without any intervention or financial support from central government. Such an arrangement would clearly achieve accountability as we have defined it. Until recently local government in the United States was based on these principles, but we know of no country, in Europe or elsewhere, where such complete local autonomy remains today.

2.4 In general, local authorities are much involved in administering

services where policy decisions are made by the national government. They also generally receive a significant part of their income from central government grants. While they remain electorally accountable to local residents, they are no longer free agents but have become, to a greater or lesser extent, part of the government administrative machine.

2.5 To preserve a measure of accountability in such an arrangement, it is helpful to distinguish services where local authorities have little discretion because of national policies (sometimes termed "national" services) and services where a significant element of local discretion remains ("local" services"). Of course, this distinction is not always unambiguous in practice, and we discuss its practical application in subsequent chapters. Nonetheless, provided some areas of local discretion can be recognised, the principle of accountability can be applied to those areas. Where local authorities have discretion over expenditure decisions, the cost of those spending decisions should fall on local residents to whom the authority is electorally accountable. The extent of local discretion varies from one country to another, but we believe that, in almost every country, local finances are organised so that where there is discretion, so there is local taxation to provide for its finance. Even in The Netherlands, where the grant proportion is very high, local authorities retain some independent taxation powers.

2.6 However, it is possible to envisage a system of local government in which local authorities had no independent revenue raising powers, but derived all their income from central government. In such a system, local authorities could still be answerable to their electorates for the allocation of funds between the various services for which they are responsible. In practice, as we have already noted, local government in The Netherlands with its very high dependency on grants, comes close to such a system.

2.7 A similar situation arises where local authorities retain a local tax, but a maximum rate of taxation is imposed on them which effectively fixes the local budget. In California, as a result of Proposition 13 (an amendment to the State's Constitution in June 1978), a ceiling of 1% has been placed on local property taxes. In the UK, the 1984 Rates Act will allow central government to limit rate poundages in certain local authorities. But Ireland has perhaps gone further in this direction than any other country with the statutory limitation on rate increases in all authorities from 1978 to 1982.

2.8 Prior to 1978, the Irish system of local finance was, in broad principle, like most others in Europe: a mix of national and local

services financed by a mix of grants and local taxes. Local authorities were free to determine their expenditure where they had discretion. The cost of such decisions would fall in large part on local ratepayers who could, to a large extent, be identified with local residents or the local electorate. The ending of domestic rates in 1978 marked an abrupt shift from this system to one in which local authorities had very little discretion over their total income (and hence expenditure). Although the power to determine the level of the non-domestic rates has now been returned to local authorities, this tax does not bear on the majority of the local electorate and thus fails the most basic criterion of accountability.

2.9 Local authorities are also being encouraged to increase revenue from charges although it is ironic that for the service which best lends itself to charging (housing), local authorities are obliged to charge nationally set rents. For some other services, however, matters are confused because households in some areas are now being charged for services which they had previously been receiving free (such as water) so that there is no link between paying the new charge and receiving the service.

2.10 The distinction between a charge and a tax is that a charge should bear some relation to the amount of a service provided. A flat rate payment for a service can be described as a charge insofar as the consumer has the option of refusing the service altogether and thus not having to pay the charge. However, as far as water charges are concerned, most urban households have no realistic alternative water supply (and in the case of refuse collection charges, households are not allowed to opt out).

2.11 There has thus been a tendency for these charges to be regarded more as earmarked taxes. Even so, such arrangements have an advantage in that, in principle, a householder may be less resistant to making a payment where he can see that he is receiving a specific service in return. It has also been claimed that in a democracy it is desirable that the taxpayer be made as fully aware as possible of how Government moneys are being spent. It is possible to argue for the new charges in terms of those considerations of political accountability. Nevertheless, flat rate charging does not have the attribute that a consumer can decide how much of a service to consume (and hence how much to pay for) as is the case for example for swimming pools.

The Basic Choice

2.12 It is therefore difficult to defend the present system on any

coherent basis: the local tax base has no electoral franchise, the Government funds are distributed on a basis which is no longer acceptable as a base for raising revenue, and local authorities are seeking to raise charges in a way which is more in the nature of a tax but are precluded from raising charges on their most tradeable service.

2.13 This unsatisfactory position has been reached as a result of a sequence of separate decisions taken over a period of years, each of which may have had a clear rationale at the time; the result does not. We think, therefore, that the system needs to be recast; it can no longer be a question of adding or subtracting parts in a piecemeal way. In saying this it must be recognised that there are no easy options, any decision will be painful and will have presentational difficulties.

2.14 It thus seems to us that the basic question that must be posed is the following: Should local authorities have restored to them their traditional discretion to determine their overall levels of expenditure, with the implication that they would have restored to them a source of local revenue (in the form either of a tax or of charges for services) sufficient to form a significant part of their total resources, or, on the other hand, should they instead lose that discretion – as in effect happened between 1978 and 1982 – with the implication that an independent local tax would no longer be a necessary part of the system? The recent changes mean that the present system is at something of a watershed: it could move in either direction. We are convinced it cannot stay as it is.

2.15 The choice between the two options is, of course, a political judgement. The impression we have received as a result of discussions with many people in central and local government, is that there is a strong preference for the more "localist" approach. We thus devote a substantial part of our report to exploring the scope for extending charges and to the search for an appropriate, independent local tax. The remainder of this chapter considers the principles which should help determine the form of reliance on charges, local taxes and central grants.

Sources of Local Finance

2.16 While there is scope for increasing charges from their present level, the scope is limited by the redistributive or public good nature of some of the services provided (e.g. roads). At present (1983 estimates) local charges met about 25% of the total cost of the sanitary services, less than 10% for refuse collection, about 20% for swimming pools and negligible amounts for other services. At their present levels, the sum of

these local charges contributes under 5% of the current expenditure of local authorities. Even if the proportion were doubled – and it is likely to be difficult enough to hold them steady – local charges would still only raise about 10% of current expenditure. Although they yield about a further 4% of total revenue, we have excluded housing rents from the above because they are charges which are nationally set; we discuss this apparent anomaly in Chapter 3.

2.17 Chapter 3 discusses the options for charges in more detail. We have failed to identify any major new possibilities for raising genuine charges, but we discuss in Chapter 3 the possibility of transferring to local authorities the take from the road tax (and the responsibility for setting its level). Like water, this would be a tax as a proxy for a charge for a service – in this case that of the provision of roads.

2.18 Voluntary payments too are unlikely to be able to yield more than very small amounts compared with the total local government expenditure. In a few European countries lotteries are used as a means of financing particular projects, but these are usually of a small nature such as children's playing facilities. Although lotteries can be useful to provide funds for a variety of such one-off projects – and they provide a relatively painless way of raising money – we do not consider that they can be thought of as anything more than that. The more widespread the use of lotteries the more difficult it is to raise revenue thereby. As the number of lotteries increases, the money raised on each is likely to fall. To coax out more money local authorities might start to compete with one another by the offer of bigger and better prizes, thereby reducing the total net income to local government.

2.19 We therefore think that a "local" system of local government finance would require authorities to have access to a local tax. The resources raised by such a local tax would be designed to replace some of the funds presently transferred from central to local government. The net effect would *not* be to increase the total burden of taxation, but rather to redistribute it; it is important to note, in the context of the comments made in Chapter 1, that such locally raised funds would enable equivalent reductions to be made in national taxation levels.

2.10 We see little merit in an assigned revenue system, i.e. one in which each local authority was allocated a proportion of the take of a national tax raised in its area. We would see this as a form of central government grant, rather than a local tax, and unnecessarily complicated as it would need to be supplemented anyway by another central grant to reduce the geographical unevenness. We therefore only

considered taxes which could be locally set and collected (either directly or indirectly).

2.21 As we stated at the beginning of this section, a critical component of a coherent, democratic system is that those liable to pay any tax should be in a position to pass electoral judgement on those who set the level of tax. This criterion of "accountability" can be supplemented by a number of further desirable characteristics which a system of local taxation should ideally display. In addition to "accountability", the following are normally considered the most important:

- (i) practicality: it should be simple for local authorities to administer and to collect; the yield should be large in relation to the operating costs;
- (ii) fairness: it should place similar burdens on people in similar circumstances in different areas (horizontal fairness) and should bear a reasonable relationship to benefits received;
- (iii) predictability: it should be possible for local authorities to be able to predict their income in order to facilitate financial control; it should also not be too "lumpy" in its yield;
- (iv) variability: it should be possible for individual local authorities to set the local tax levels without adverse consequences on themselves or on neighbouring authorities;
- (v) compatibility: it should be compatible with the national taxation system in particular with regard to the overall impact of the tax system on economic efficiency and of the relationship of total tax burdens with ability to pay; it should be possible for central government to consider the overall balance of taxation.

2.22 The local tax currently available to local authorities is the rate base provided by commercial and industrial ratepayers. As presently arranged, this tax fails the basic test of accountability. It was possible to justify the position of commercial and industrial ratepayers while their rate levels were tied to those for domestic ratepayers as the latter formed the electorate; now it is not. So far local authorities (and the Managers) have not exploited the commercial and industrial ratepayer base but this is the result of good faith as there are no checks and balances in the system. We think the present arrangements are unsatisfactory; they are also unfair. There are two alternatives: if some new form of comprehensive local property tax were to be introduced, the commercial and industrial tax base would naturally fall within it. If not, the level of commercial and industrial rates should not be at the discretion of individual local authorities.

2.23 The lack of accountability of non-domestic rates lies deeper than the obvious point that businesses have no votes. When a tax is levied on a business it has to find the money either by raising prices to the consumer, by paying less wages to its workers or less rent to its landlord, or by producing less profit for its owner (or shareholders). Alternatively, faced with a higher rate bill, it can leave one district and set up elsewhere, or it can close down altogether. As far as large firms are concerned most of their customers, their main shareholders and many of their workers may live outside the local authority in which the firm is situated. By levying non-domestic rates on such a firm, a local authority is in effect imposing a tax which is, ultimately, paid by people living outside that locality. It is in this sense that there is a lack of electoral accountability.

2.24 To balance such lack of electoral accountability there is the local concern, particularly in times of recession, about employment opportunities; for this reason local authorities will wish to hold down non-domestic rates. In fact we gather that, rather than "competing" on the level of non-domestic rates in order to attract and encourage local businesses, in the last couple of years local authorities have in fact set very similar levels of non-domestic rate increases. While such uniform behaviour continues, the non-domestic rate does not provide a locally variable tax (it is more in the nature of an assigned revenue at a level determined by the consensus of local authorities). If, however, the consensus breaks down, and local authorities set non-domestic rates at quite different levels from one another, the situation appears to become potentially rather unstable with nothing to link the outcome either with the appropriate level of local government spending or with the appropriate balance of taxation between different sectors in the economy as a whole.

2.25 It is for these reasons that we think that the level of taxes on businesses should in general be determined by central government, especially if they are not tied to some local tax which is levied on the local electorate. For the reasons given in paragraph 2.23, electoral accountability is more relevant at the national level; it is still not perfect, since some of the customers of, or shareholders in, Irish firms may be foreigners. The problem of tax "competition" between localities disappears if the tax is set centrally. And central government is best able to judge the appropriate balance of taxation between different sectors of the economy.

2.26 None of this is to say that businesses should not contribute to the costs of local government services (often provided as much for the

benefit of firms as for households). Indeed the argument that firms should contribute to such costs has particular force in Ireland where road maintenance forms so large a part of local government spending. The point of the above arguments is that it is more appropriate that the level of such a contribution should be determined centrally than that the local authorities should be free to tax firms in an unconstrained way. An alternative, as we will argue in Chapter 4, is that, if a new form of property tax (levied on the local electorate) were to be introduced then the non-domestic rates should be included within it.

2.27 For the same reasons we have not considered a local payroll tax. This would be a levy on employers within a local authority area in proportion to their total wage bill. Such a tax also fails the basic test of accountability. At the most obvious level, the tax is paid by the employer which could give the appearance that most people would not be liable to the tax at all. But even were the tax deducted from the employee more directly, it would still fail the test of accountability because it would be levied on people where they worked rather than where they lived and had votes in local elections. In addition to these arguments against payroll tax as a local tax, we should mention that the Commission on Taxation in its First Report (Chapter 21) has argued against any form of payroll tax within the national tax system on grounds of economic efficiency, fairness and tax administration.

2.28 A local poll tax in contrast, appears to be more straightforward to administer, but the appearance is somewhat deceptive. At present people are only registered according to their place of residence for the electoral register. However, smooth running of elections depends on people voluntarily placing their names on the electoral register. If the register were made the basis for a local poll tax, there would be a disincentive for people to leave their names off the register in order to avoid a tax liability (which might "save" them several hundred pounds). To avoid this problem, it seems likely that if a local poll tax were to be introduced there would either have to be a new administrative mechanism to ensure that everyone was registered for the tax, or else the tax would have to be levied on households rather than on individuals.

2.29 The other main disadvantage of a poll tax is that an individual's tax liability bears no relationship to his ability to pay. If a local poll tax were to make a major contribution to local finance the tax rate would have to be high, perhaps around IR£250 per head of the adult population. Taxation at this rate would impose an unacceptably heavy burden on poorer households. If there were a system of reliefs for the poor, the tax rate on others would have to be correspondingly high

and there would also be additional administrative costs. Further, the more sophisticated such reliefs were made, the closer the system would resemble an income tax.

2.30 There are many possible taxes whose revenue yield is small, examples from other countries include taxes on betting and gaming, sports, entertainment, timber sales, mining, dogs, horses and cattle, tourism and the sales of alcohol and tobacco. Such taxes can often usefully supplement a major revenue source, but cannot in our view constitute the basis of the system of local government finance; in only two OECD countries do such taxes raise more than 2% of local government revenue. Because of this low yield and limited coverage, accountability is poor. Often administrative costs are high and in some cases there may be scope for evasion.

2.31 There are three major options for raising tax revenue at the local level which we considered in detail:

- (i) some form of sales tax;
- (ii) some form of local income tax;
- (iii) some new form of property tax.

2.32 None of these options is novel — indeed we doubt that novel ideas exist in this area given the amount of study to which it has been subjected. There are many examples of each of these taxes operating in various countries of the world. We examined each and its consequences (e.g. for a rebate system) in the Irish context, and against the criteria outlined in para 2.21 above. Chapter 4 sets out our analysis. We identified what would be fairly major difficulties in Ireland with the local sales tax and the local income tax. A major difficulty with a new form of property tax would be presentational; a significant advantage is that it would serve to widen the tax base and thereby would address some of the wider problems outlined in Chapter 1 above.

Central Government Grants

2.33 Whether or not a new local tax is put in place, local authorities will still need to derive revenue from central government grants. Any grant system requires a procedure first for determining the total amount of the grant and second for allocating that total among local authorities.

2.34 For the first, one possibility would be to create a "pool" of funds by earmarking a fixed proportion of national taxes — for example the equivalent of a given rate of income tax or part or all of VAT. This would:

- (a) provide buoyancy for the pool (although the degree of buoyancy would depend on the tax chosen), and
- (b) provide a degree of predictability for local authorities (again to some extent depending on the tax),

but it would:

- (c) offer the Exchequer a tempting source of funds in times of stringency and would not help with the problems of the narrowness of the tax base outlined above.

To overcome this last point, it might in principle be possible for the Government to introduce a new national tax, for example an extended property tax as a national tax, to which might be added the revenues from commercial and industrial rates.

2.35 However, it has not been within the scope of this project to consider new national taxes. Furthermore, history would suggest (for example with respect to the road fund pool) that the third point (c) above would be the downfall of any such system. It seems to us that the size of the pool should be determined as part of the public expenditure process. We would also suggest that the process of determination should involve the local authorities in a forum between central and local government set up for this purpose. Although we recognise that for more than the first year figures could not be more than indicative, we also suggest that the forum should seek to produce estimates for the size of the pool on a four year rolling basis.

2.36 Whatever method is used for determining the size of the central pool, crucial decisions would be needed about the distribution of the pool to the local authorities. In general, we see advantages in designing a grant allocation system such that the grants local authorities receive are related to an assessment of their relative spending needs. In a system in which local authorities received the bulk of their funds from central grant and had no independent local tax, the grant allocation system would be of key importance. We examined the system in The Netherlands as being the closest parallel, and concluded that a system along such lines would be feasible in Ireland.

2.37 In a system where local authorities receive a significant part of their funds from local taxes, we see advantage in a grant system based on the principle of equalisation. Again it seems to us that such a system would be perfectly practicable in Ireland.

2.38 We examined options for a grant system, both with and without

a significant source of local taxation revenue. Our analysis is set out in Chapter 5.

Conclusion

2.39 In summary, we consider that a grant based system of local government finance would be a possibility for Ireland. The grant system would need to be a combination of specific and block grants, commercial and industrial rates should not remain as a tax which local authorities were completely free to set at their own discretion, and any significant charges should be set within centrally determined guidelines (e.g. not to exceed the economic costs).

2.40 Such a change would not be a dramatic one for Ireland given that past decisions have already taken the system a long way in that direction. It might seem to be a break with the tradition of Irish local government, but the major break was made, albeit for a different purpose, when domestic rates were transferred to, and then controlled by, the State. The restoration of freedom over commercial and industrial rate levels could be interpreted as a step back from the brink of a central system, although, in the context of moving back to a more local system, it is an illogical and inconsistent step.

2.41 By itself, such a change would not resolve the problems of the narrowness of the present tax base: that can only be done by the introduction of a new tax. Under a central system of local government finance, it would not be essential to introduce a new tax, but if any were introduced it would, of course, need to be a national tax.

2.42 But we think the alternative would also be possible in Ireland, that is a system of local government finance with greater local discretion. However, this would only be possible with a new local tax – the options for which we discuss in Chapter 4. Even with a new local tax base there would still need to be a significant transfer of central funds to local authorities by means of a grant.

2.43 This then is the watershed on local government finance at which Ireland finds itself. We consider the present arrangements to be untenable for long. The choice is to continue with the changes of the past decade and move on to a "central" system of financing – with the option of also introducing some new, national tax; or, on the other hand, to move back to the more traditional Irish arrangement of a "local" system, for which a *sine qua non* would be a new, local tax. Neither path will be easy.

CHAPTER 3

CHARGES

3.1 Charging for services has long played a role in Irish local government. For some services (for example swimming pools) the method used takes the form of a genuine charge for a service rendered; for others (for example water) the method has some of the characteristics of a tax, in that it is unavoidable and does not vary with the quantity of the service consumed. Recently there has been increasing emphasis placed on the role of charging as a method of raising revenue for local government: local authorities are now empowered to set and levy charges for any of their services which are provided for individual consumption. The major exception is local authority housing for which the charge is set nationally.

3.2 The present period of retrenchment is a particularly difficult time to increase the emphasis on charging as the extra revenue yielded no more than balances the real reduction in the amount the State provides. The general public can thus not see any positive improvement in services as a result of their payments. It is partly for this reason that the levying of charges is sometimes claimed as "rates by the back door". There is some strength in this claim insofar as charges have helped make up the shortfall on a grant that was intended to be for the relief of domestic rates.

3.3 Local authorities are naturally reluctant to make or increase charges in such circumstances, as there is no visible benefit accruing to the authority either in terms of improved services or reduced domestic rates – the argument that services would have been even worse if charges had not increased is not an easy one to present politically. In some authorities the issue has been the subject of disagreement between the elected Councillors and the Manager. Some Managers accept the need to move toward economic charges, whereas Councillors have tended to see little political advantage in so doing. The result is a recipe for further confusion in the eyes of the public in terms of identifying where the true responsibility for such decisions lie – the Government, the Councillors or the Manager.

The Principles of Charging

3.4 The validity and relevance of charging for publicly provided ser-

VICES depends on the objectives of the service. For services whose prime function is a redistributive one to charge the full economic cost would defeat the object. It could be argued that it is inappropriate for any major redistributive function to be financed at the local, as opposed to the national, level; indeed all the main services with a primary redistributive aim (education, health, welfare) are arranged and financed at the national level.

3.5 But there are redistributive elements associated with some of the present local authority services too. For local authority housing this element is reflected in the rent structure which is geared to the household income, for water it is reflected in the existence of a relief system. In the same way as for redistributive services, it is more appropriate for the redistributive element within a service to be funded at the national level. This has general implications for rebate/relief systems which we discuss under the service headings below.

3.6 The extent to which a service is supplying a public good (i.e. one for the benefit of the community at large) rather than a private one is also important in the context of charging. Most public services contain both elements – for example refuse collection undoubtedly benefits the household from which the refuse is collected, but it is also a benefit to the public at large that refuse should be collected in a sanitary way. The greater the public good element, the less valid it is to charge the full economic cost.

3.7 The setting of a level of charge for a service needs to strike a balance between both the various objectives of the service (including the extent to which it is a public good) and any wider financial objectives of the authority as a whole – for example about alternative sources of revenue. There may also be problems associated with the monopoly position of the authority as a supplier of the service and the possible need to provide proper audits of costs to ensure that the monopoly is not abused; this is unlikely to be a problem in the short term. The issue of charging is further complicated by questions of the practicality and efficiency of the means by which charges can be levied. It is the combination of these factors (public good, practicality, efficiency) which led us to conclude above (Chapter 2) that charging is unlikely to provide a significant proportion of the total funds required for local government.

3.8 For any one service the actual level of charge must, at the end of the day, be a matter of political judgement. But, in view of the public expenditure points made in Chapter 1, there would be significant

advantages in moving as close as possible to economic charges for any service which lends itself to charging. We are not convinced that the present arrangements for charging provide the best means of achieving this. We discuss below, on a service by service basis, the scope for change.

Charges for Services

(a) *Sanitary services*

3.9 Most authorities now levy a charge for water, and some a separate charge for sewerage. This has been the position in the non-urban authorities for some time but is relatively new for the urban areas. The result is a geographical unevenness in the extent to which local revenue can be increased in this way – the scope for increasing revenue by such charges is significantly less in the rural areas. We understand that, partly as a consequence, the consumer resistance to such charges has been most vigorous in urban areas.

3.10 The Department of the Environment estimated that the total revenue raised by charges for water and sewerage should have been about IR£33m in 1983 (including charges for non-domestic consumption) – although only about half of the revenue due from domestic consumers had been collected by the end of the year (see para 1.25). The costs of the two services in that year were estimated at about IR£135m of which the expected revenue for charges represents about 25%. Although figures are not available on an authority by authority basis our discussions would suggest that the average of 25% is likely to span a very wide range which implies that there is still scope for significant increases in some authorities.

3.11 For domestic consumers the levy is not a charge in the strict sense. Some authorities band dwellings according to their (old) rateable value and then levy a flat rate on each band; most authorities levy a single flat rate on all households. A few authorities levy separately for sewerage.

3.12 We have already mentioned two explanations given to us for the consumer resistance to water charges: that some people feel they are being charged twice for the service (para 1.26) and that the charges were viewed as “rates by the back door” (para 3.2). What is not clear is the extent to which the resistance to water charges has stemmed from the fact that the charge appears to take the form of a tax, and in particular looks like the abolished domestic rates, even to the extent of being levied with reference to the old rateable values. To facilitate the move towards economic levels of charges we think that it will be important for the public to understand what it is they are paying for and why, and to recognise that the method of payment is a fair one.

3.13 We therefore considered whether any other form of charging might help achieve economic levels. We think there would be no advantage in changing from one proxy base to another (for example to floor area, number of taps in the dwelling, etc), not only because it would be no clearer that such a base was fairer than rateable value, but also because a new data base would be needed. We do however think that it would be worth considering phasing in water metering for domestic consumers; large non-domestic consumers are already metered.

3.14 As water charges increase and the cost of meters falls, so metering becomes more of a feasible proposition. The average installation time for a domestic water meter in the UK has been estimated as between 1 and 2 hours; meters now cost between IR£10 and IR£20, and probably nearer the lower figure for bulk purchase. In an area in England (Malvern) in which domestic metering has been the norm for many decades, it is estimated that annual running cost is about £9 sterling (1980 prices) per meter (to cover replacement, inspection, reading, collection and billing) compared with £1-2 sterling (1980 prices) for a rate based system.

3.15 Further savings could be set against these costs in Ireland, including, possibly, the costs of maintaining and updating the domestic rating valuation list; although, of course, the abandonment of the valuation list for domestic properties would have to be considered in the broader context of the future of the property taxation system as a whole and not simply in terms of water bills. It could be expected that metering would produce a greater compliance with the charge, saving administrative and legal costs and revenue shortfall; we have not sought to estimate this, but metering would put water on the same basis as electricity for which we understand there is less difficulty in recovering charges. Metering might also reduce consumption resulting in lower current and capital expenditure.

3.16 A further advantage of water metering is that it would facilitate charging for sewerage too – albeit by measuring input in order to charge for output. Although such a measure would be a proxy one, we think that the connection would be readily seen by the public. We therefore think that the case for the metering of domestic water is sufficiently strong to justify a full study of the issue. We suggest that the Department of the Environment should commission such a study as soon as possible.

3.17 Large non-domestic consumers of water are already metered, but

many authorities do not meter the smaller non-domestic user. The rationale given is that such users are still paying rates and that this should be taken to cover their water usage. We think this is inconsistent; not only do large users also pay rates, but domestic users are charged while nominally having their rates paid by the State. We suggest that there are no grounds for exempting any class of consumers from water charges and that authorities should be encouraged to extend charges to all users. Any study of metering should embrace all non-metered users.

3.18 By the nature of sanitary services, there must be facilities to assist households which cannot afford the charge, no matter what method of charging is employed. At present the Government issues guidelines about categories of household which might be exempted; we gather there is wide local variation in their implementation. As we have argued above, any "redistributive" mechanism of this nature should be funded at national level. There is no reason why the same mechanism which currently applies to electricity charges should not also be used for water under a metering system.

3.19 Whether it is worth redesigning the present system for water rate reliefs depends on whether it is likely that a meter system would be introduced and, if so, when. The simplest change within the present system would be that the central guidance about relief should become obligatory with the consequential loss of income to authorities being made up by the Government (with a balancing reduction in the aggregate support to local authorities). This would be far from ideal because rebates should in general be given on a sliding scale; but the sums involved are likely to be sufficiently small for this not to be a major problem for the time being.

3.20 Finally, we note that State subsidies for capital development of sanitary services are unique in being at different levels for different counties. While in most areas the subsidy level is 50%, in the traditionally "wealthier" ones it is 40% and 60% in the traditionally "poorer" ones (and 85% in the Gaeltacht). The designation of the areas was made at the beginning of the century, and the three point scale is rather crude. Nevertheless the scale is the only facet of Government support for local authorities that could be said to take account of "needs". What is less clear is why sanitary services should be singled out for special treatment in this way. In Chapter 5 we make suggestions for the development of a new system for grants from the State to local government; these would subsume the present arrangements.

(b) *Environmental protection*

3.21 The two major services in this programme are waste disposal and fire protection. The only possible method of charging for fire protection is by means of private insurance. Because of the significant public good component of fire protection – quite apart from the practical difficulties in that the service could not be delivered on a selective basis, any insurance scheme would need to be compulsory, much as it is for motor vehicles. However, unlike motor vehicles, it is difficult to envisage what sanctions could be brought to bear on non-insurers. Because of the practical problems, and the wider questions of public policy, we have not sought to explore this idea further.

3.22 For refuse collection, some authorities already charge, normally in the form of a flat rate levy. The Department of the Environment estimates that about 10% of costs are aimed to be recouped through charges. As a service, waste disposal has a major public good component, and hence it would not be appropriate to consider charging full economic costs.

3.23 Again, the levy is more like a tax than a charge in the strict sense; for waste disposal we think it would be impractical to devise a form of charge which was directly related to the "volume" of service consumed. The only options we considered would be to charge for each bin emptied either directly or via a system of prepaid waste bags. We understand that each of these avenues have been considered by one or two authorities – although not by means of a formal study. We agree with what we gather were their conclusions – that the administrative and practical difficulties associated with such methods would be overwhelming; we also accept the point made to us that there could be serious problems of non-compliance.

3.24 Another possibility is that a basic level of service, say one bin per household, would be provided free as a public good, but any extra demand by heavy users would be the subject of a charge. The same practical difficulties would arise with private households, but such an option could be explored for shops, restaurants, etc.

3.25 The charge for refuse collection must therefore remain on a basis which resembles a tax; we considered whether there might be ways in which it could be related in some way to indicators of the volume of service, for example by linking it to a measure of household size. The most straightforward measure would be the electoral register, but despite the smaller sums involved, we still think this method would have some of the same disadvantages as a local poll tax (see Chapter

2, para 2.28). As the sums involved in refuse collection are relatively small, we doubt whether they would justify establishing a data base especially for the purpose of levying refuse collection charges.

3.26 However, it may be worth considering proxies for household size if such data were already to be collected for some other purpose. If a water meter system were implemented then the volume of water consumed would give some indication of the size of the household and so might provide a possible proxy measure for charging for refuse – just as it would for sewerage, although without such a close and obvious relationship. However, in view of the relative smallness of the sums, we suggest that this matter should not be given high priority until the major problems of local government finance raised elsewhere in this report have been addressed.

(c) *Roads*

3.27 The road system in Ireland has two well defined parts. The "national" roads, though the responsibility of local authorities, are wholly financed by central government; the "local" roads are the direct financial responsibility of local authorities. The revenue expenditure is roughly the same on each of the parts (around IR£100m on each in 1982). The plans and priorities for the national roads are set out in a published document which is produced by the Government, but only after discussions with the local authorities.

3.28 National roads are recognised as a national service and as such are funded by the State. Local authorities "charge" the State for the work they do on the national roads, although the "charge" actually takes the form of a direct grant from the State to the authority; the grants are made on the basis of a programme agreed between the two parties. In effect the local authorities act as agents of the State. The advantage of using local authorities as the State's agents for this work – rather than setting up a separate organisation as for Health Services – is that the authorities have responsibility for a number of closely related services, not least for local roads, but also for planning and development.

3.29 We think the arrangements for the national roads work well (and perhaps provide a model for housing if it is decided that it too is a national service – see below). One relatively minor point is that the grants are made on a project by project basis which results in an unnecessary rigidity in project planning. There would be advantages in the national grants being pooled for each authority, although still on the basis of an agreed programme; we suggest this be considered.

3.30 Local roads, by contrast, are the responsibility of the local authorities, although there is still a small element of specific Government grant which is made available for submitted schemes. The local road network in Ireland is very extensive and hence costly to maintain. Because it is an easy programme to cut in times of financial stringency, the local road programme has suffered in recent years, and in some cases the value of the original investment has been allowed to decline. Although it is outside the scope of this study, we think there would be merit in considering some rationalisation and reduction in the minor road network, with a view to reducing its claim on public resources. We recognise that such an examination would be long and probably contentious. For roads with very limited use it might be worth considering whether more of the costs of their maintenance could be borne by those who use them.

3.31 The only method of charging directly for road use (on national or local roads) would be by means of tolls. The facility to make such charges has existed since 1979, predating the general powers for charging. The main purpose of the legislation was to provide for tolls in the context of new road construction projects. The objective was to encourage private finance into road construction by providing the facility for generating a return on the investment made. The interest from the private sector has been limited so far, but we understand that several possible projects are now under discussion.

3.32 Although we gather that the legislation would allow tolls on existing roads, it was never the intention that they should be used as a major source of revenue either for local authorities, or, on national roads, for Government; there is an additional complication on national roads (illustrated by the difficulties with the Naas bypass proposals) of a lack of clarity of the relative responsibilities of the local authority and the Government.

3.33 There would be two difficulties in seeking to charge tolls on existing roads. First, the road system consists of an extensive network of minor roads which means that not only are there a large number of different ways of getting from A to B, but also that any given stretch of road is crossed by many other roads even over relatively short distances. This would make tolling very difficult in practice: a large number of side roads would need to be blocked off, and even then much traffic would be able to find alternative routes.

3.34 The second difficulty stems from the fact that roads have always been a "free" good in Ireland. It was impressed on us that charges of

any significant size for existing roads would be likely to be strongly resisted; and would drive the search for alternative routes. We think that the combination of these physical and psychological factors means that it is not possible to consider tolls as a generator of significant resources either for local authorities or for Government.

3.35 The only other method of raising income from roads is by taxation. At present road tax is the responsibility of central government, although local authorities act as agents and collect it. When originally devised, around the turn of the century, the road tax formed a fund which was used for the building and maintenance of roads. By the 1950s the fund was subject to periodic raids by the Exchequer and was subsequently discontinued altogether as a separate fund. It now forms part of general taxation and as such accrues to central government.

3.36 There is no *a priori* reason why the road tax should be a national one rather than a local one (nor indeed *vice versa*). The decision as to which would be more appropriate hinges on the more general approach adopted towards local government finance (see Chapter 2). If the approach is to be one in which the balance is weighted heavily towards the centre, then the road tax should be retained as a national tax.

3.37 If on the other hand the approach is to revert to a system with more weight given to local autonomy with an independent source of local tax revenue, then there would be advantages in converting the road tax to an additional source of local revenue for authorities. As such the level of tax would be set and collected by the authority as a proxy "charge" for the road service. Such an arrangement would give an added incentive to the collecting authority to collect all the tax that was due. In the first year there would need to be an equivalent once-for-all reduction in the aggregate support given by the State to local authorities.

(d) *Housing*

3.38 The extent to which local authority housing is a public good is to some degree a matter of judgement. Certainly some of the original rationale was that public housing should replace disease-ridden slums; the benefits were therefore public as well as private. It is less clear that there is still a significant public good component today. If not, then there is a strong case for tenants to be charged full economic rents. The only inhibiting factor is that many tenants would not be able to afford such a rent — but this is an argument for an efficient system of rent rebates, or reliefs or, perhaps of tax credits for the less well-off, rather than for a general subsidy.

3.39 But the confusion on public housing is more fundamental. Housing is the most tradeable service for which local authorities are responsible – the one which most naturally lends itself to charging. And yet it is the one service for which authorities are not free to raise charges as they think fit. The rent regime (unlike, say, the level of water charges) is set nationally and has been since 1977, although before that, local authorities had some discretion over the level of their rents.

3.40 The inference is that public housing is in fact a national service with local authorities acting as the agents of the State. This view is reinforced by other aspects of housing: the proportion of debt charges on new house building met by central government has been increasing over the years and now stands at 100%. In addition, the policy on sales and the level of discounts are determined centrally, the Government imposes some limitations on how the proceeds of sales shall be used and all schemes for new building need cost plan approval from Government.

3.41 In our discussions we found a fairly general degree of acceptance that public housing was now essentially a national service. In some cases there was regret that for another major service the local responsibility was shifting (and had to a large extent already shifted) from local to central government. Public housing is now seen as a national issue; it is a matter of great concern to many TDs and to Ministers; it forms the subject of debates in the Dáil and it is an issue in national elections. This political reality we found to be accepted even by those who regretted it.

3.42 If there were to be a significant change in the political climate, it would require two major changes for public housing to revert to a local service. The first would be some reduction in the State subsidy for debt charges below the present level of 100%. The subsidy should still take the form of a specific grant; on the grounds of equity the level of subsidy should be more in line with that currently made available by the State to owner occupiers. The total subsidies to owner occupiers, who form about three quarters of households, is something over IR£100m p.a. (1983) with pressures for it to be reduced; this includes the cost of mortgage interest relief as well as the grants for new houses and improvement, it does not include the exemption from capital gains tax. For public housing, forming about 10% of households, the total level of capital subsidy has now risen to around IR£150m p.a. (1983). This figure is the accumulation of subsidies from previous years – at less than 100% – as well as the more recent 100% levels; it has recently been growing very rapidly. The loan charges subsidy alone has increased

from just over IR£60m in 1980 to about IR£125m in 1983 and is estimated at about IR£155m for 1984.

3.43 To produce equivalent pictures for the subsidies to the different tenures is complex – although attempts have been made (e.g. by An Foras Forbartha in 1978). Nevertheless the above figures do suggest a high degree of imbalance between the tenures – and poorer households are not exclusively confined to the local authority sector. The important point is that the balance between the levels of subsidies given to the different tenures should be struck as a result of conscious decisions, it should not simply be a consequence of other decisions.

3.44 The second major change required for housing to revert to a local service would be to restore to local authorities the freedom to establish their own rent levels – within the context of setting the levels for other sources of their income. Rents would then become a genuine local charge and, if they were set at an economic rent, would be a major source of revenue to local authorities. We think this would only be compatible with a system of local government in which authorities had an independent tax source against which they would need to balance any reluctance to set rents at economic levels. To cope with the concern about redistribution, it would be essential to have a rent rebate/relief scheme, which, as we have argued above, should be funded at the national level. This could be arranged either through the Social Welfare System (as for ESB reliefs at present) or by using the local authorities as the State's agents. It may well have been the lack of an adequate, national rebate scheme which led to some of the dissatisfaction with rents in the mid 1970s.

3.45 However, we think that the political reality is that housing is likely to remain a national service; but the transition from what used to be a local service is not quite complete. One major financing illogicality remains: any deficit on an authority's housing revenue account has, at present, to be met from local rather than national funds (although of course the rate fund is now heavily State financed). Over the country as a whole, local authority housing rents meet only about half of the management, maintenance and repairs costs, although the percentage shows great variation between local authorities; in some it is close to 100%. We found that some authorities operate an implicit (but unstated) policy of seeking to adjust the revenue expenditure on housing to an amount that almost matches that raised by rents. There is always the danger that such an approach will lead to an inadequate protection of the capital investment which the housing represents – quite apart from the risks of allowing living conditions for tenants to become substandard.

3.46 If, as we suggest, housing is to be thought of as a national service, local authorities should be in the same financial position *vis-à-vis* the State as they are for national roads. For the national roads programme the State provides specific grants covering not only capital expenditure but also all the revenue funds for repairs and maintenance, i.e. the financial arrangements reflect the fact that the local authorities are acting as the agents of the State.

3.47 There are of course, important practical differences between the national roads and public housing, the main ones being that housing generates (via rents) a significant income and that the management and maintenance services for housing do not form projects with identifiable project costs. Housing revenue expenditure can not therefore be the subject of "bids" and a forward programme in the same way as can repairs and improvements for roads. Nevertheless there are numerous examples of one body acting as a managing agent for another in which cost control is achieved by effective management information systems.

3.48 We suggest therefore that the *de facto* position on housing be recognised in the financial arrangements, with specific grants to cover the total net costs and with adequate management information and efficiency targets in order to protect the Exchequer. We also think there would be merit in producing a document for public housing which would be the equivalent of the national roads document. This would set out the priorities and programme over, say, a five year period, covering not only new building but also any major repair or refurbishment scheme.

3.49 Shifting this final element of financial responsibility to the State does not imply that the current level of public subsidy should remain unchanged; in fact the change would provide the opportunity to rationalise the present position and make it easier to move to economic pricing. The responsibility for servicing the capital debt and for meeting the revenue deficit would then both rest with the Government, and so could be considered together. Other than the size of the specific grant and the details of any management system, finance for public housing would become the sole responsibility of central government and cease to be a problem of local government finance.

3.50 As such, public housing finance would fall outside the scope of the present study (in fact we consider that the problems of housing finance in general merit a further urgent study in their own right). But there are two serious criticisms of the present approach to setting rent levels which are worthy of immediate comment — not least because,

under the present arrangements, local authorities have to finance a proportion of the resulting deficit.

3.51 Our first criticism relates to the way in which the maximum rent is set for any given dwelling. The present system calculates a fixed percentage (5.25%) of the updated historical cost of building the dwelling, this cost being updated annually. But the updating is by reference to the Consumer Price Index which has tended, until recently, to underestimate present costs compared with either the index of House Building costs (available since 1968) or an index of house prices.

3.52 The 5.25% applied to the capital cost is made up of three parts: 1.25% is intended to cover management and maintenance costs, although we could find no basis for using this particular figure. As the actual costs of management and maintenance are known to each authority (in aggregate over all its dwellings), we see no reason why they should not be used for this calculation. To do so would also help provide an incentive for efficiency to the authority.

3.53 A further 2% is for a sinking fund for replacement, calculated, we understand, on the basis of an assumed 80 year life for any one dwelling; if it is to cover likely replacement costs, the 2% should be taken of the capital cost updated by the House Building index not by the CPI. The final 2% is intended to provide a real rate of return on the capital made available to construct the dwelling. Calculating the 2% on the annually updated capital cost ensures that it is 2% in "real" terms (i.e. 2% above the rate of inflation). For this purpose the CPI would seem the more appropriate index. The above changes would produce a maximum rent closer to the economic rent than the present approach.

3.54 But there are shortcomings with using an updated capital cost as the basis for these calculations, no matter what index is used. Using an index can not take account of market changes and will not therefore produce updated capital costs which reflect the desirability of the dwellings. The resulting maximum rents, while they may be close to economic rents (if the right indices are used) will not reflect market rents. One way of doing this would be to use the current capital market value of the dwelling as the basis for both of the 2% applications, although we appreciate that a mechanism would be needed to estimate capital values (this would be available if, as we suggest in Chapter 4, a capital based property tax were introduced) — but see also para 3.58 below. To increase the degree of choice in local authority housing and to reduce some of the rigidities in the market, we suggest that the change be made to capital values as the basis for applying the 4%; the

maximum rent would be the sum of this figure with the actual costs for management and maintenance.

3.55 But such a change on its own would be fairly meaningless as we understand that only about 2% of tenants are at present eligible to pay their maximum rent. This brings us to our second main criticism which concerns the approach used, as it has developed in practice, to calculate the rent payable for any one tenant. Under the differential rent scheme, the calculation of rent payable is by reference to the assessable income of the principal earner — basic income, net of income tax and PRSI and with allowances for dependent children. The assessable income is banded, a weekly allowance subtracted for each band and a proportion (again varying with each band) applied to find the rent payable; additions are then made for subsidiary earners. We think the differential rent scheme, as it has evolved, is inequitable, calculated in an inappropriate manner, unrealistically generous and incorrectly funded.

3.56 On the first count, we see no reason why all income should not be included as assessable — if it is unpredictable then some expected average based on the previous year could be used (as at present by the Revenue Commissioners). The exclusion of shift allowances, overtime and lump sum bonus payments means that the income from those in work is almost invariably underestimated, and the higher the income the more it is underestimated. This was clearly demonstrated by V.C. O'Brien ("Review of the differential rents scheme" — 1983) in which he showed that as actual income increases, the proportion assessable for rent purposes decreases. The exclusions also allow scope for false declarations of basic income; our discussions suggested that this was not unknown. In contrast, for those whose main source of income is from Social Welfare (estimated at just over half in the above study) all their income is assessable for the rent calculations.

3.57 On the second count, the method of calculation produces a series of poverty traps at the boundaries between the bands — for example, in the 1983 scheme, an increase in assessable income from IR£74 per week to IR£75 per week would result in an increase in rent from IR£2.70 to IR£6.30 per week. Much the simplest way of avoiding this would be to have a fixed principal earners allowance (perhaps equal to the basic social welfare payment) together with a fixed rent fraction and dispense with income bands altogether — other more sophisticated systems have been suggested to us, but we see significant advantages in simplicity.

3.58 On the third count, there seems no good reason why a significantly

higher proportion of tenants should not pay their maximum rent. The point here is one of balance between subsidies for the housing tenures and relates to national housing objectives — the National Planning Board, in its recent report, made a plea for a better balance between the three tenures. An alternative approach, suggested by O'Brien, would be to dispense with maximum rent levels altogether which would save the problem of finding a way of calculating it. This approach seems worthy of consideration, if it were politically feasible; it might also act as an incentive to house purchase for the better off and would therefore further help another Government objective.

3.59 Finally, since a rent scheme graded by income is a redistributive mechanism it should be centrally funded. Under the arrangements we suggest for public housing finance in general, this would automatically be the case and no further adjustments would be needed. But while the present split in responsibilities remains, the State should make up the difference between the total revenue due to an authority if all its dwellings were let at maximum rents and the actual rent resulting from the application of the relief scheme.

3.60 In summary, we think the Government should decide whether it wishes public sector housing to be a local service or a national service locally administered. If the former, local authorities should be free to set rent levels, a rent relief system should be centrally funded and direct State subsidies should be reduced to be more in line with those given to other tenures. If, as we suspect, the latter, the Government should take over responsibility for all funding using local authorities as their managing agents (with appropriate safeguards) and produce a rolling plan for housing as at present produced for roads. Meanwhile, changes should be made as soon as possible to put the calculation of rent ceilings and rent levels on a more reasonable and equitable basis.

3.61 However, the whole problem of housing finance is complex and, in the context of this report we have only been able to comment on some of the issues involved. We would see significant merit in a separate study into the whole issue of housing finance; in view of the state of flux of the rest of local government finance we think such a study would be timely now.

(e) *Other services*

3.62 There are several other services for which local authorities can, and do, raise charges: e.g. for swimming pools, libraries, planning permissions, sheep dipping etc. The sums involved are very small in comparison with total budgets, and no changes to them would be

likely to have any significant impact on the overall problem of local government finance. We have not therefore considered them further, except to note an inconsistency inherent in setting the charge for planning permissions at national level – in our discussions we have found no sound reason why the level of this charge should not be a matter for local discretion.

3.63 We have also noted the anomalous position of the various statutory demands which make up programme 7. The payments cover activities within agriculture, education and health and welfare; in 1982 the programme 7 gross expenditure was about IR£50m, i.e. about 6% of total gross expenditure. Local authorities have no control over the size of the payments and the various bodies to which they are paid are statutory, centrally funded ones for which local authorities have no powers or responsibilities. Since most of local authority resources now derive from the State, the effect of the arrangement is just to channel some of the funds for these bodies through local authorities.

3.64 The only reason put forward for these arrangements was that some proportion of the funds so paid are in fact raised locally and that this reduced the total burden on the Exchequer. We think this argument is unsound; since the bodies and functions involved are not part of local government's responsibilities, we see no reason why they should be called on to pay part of the costs from their own funds (and from the commercial and industrial ratepayers in particular). Further, since the arrangements are simply substituting one form of public expenditure for another, there is no macro-economic advantage in so doing. Finally, the extra administrative arrangements needed to make (and receive) these payments must in themselves cost public funds.

3.65 We therefore think that these arrangements should cease, with responsibility for such payments transferred to the relevant Government departments. We understand that submissions have been made to this effect for some time; they should be accepted and implemented as soon as possible. The amount of general support given by the Government to local authorities would need to be reduced by an amount equivalent to the "channelled" element of the payments; this would of course be a once-for-all reduction, not an annually calculated one.

CHAPTER 4

LOCAL TAXES

4.1 In Chapter 2 we explained that there were three main candidates to be considered as possible taxes which could be set and raised by local authorities as a main source of revenue. They were: a local sales tax, a local income tax and some new form of property tax. This chapter considers each of these in more detail. We explained in Chapter 2 that a critical component of any coherent, democratic system was that of accountability. We also listed a further five desirable characteristics for any local tax system; these five were (para 2.21): practicality, fairness, predictability, variability and compatibility.

4.2 A sales tax must be designed within the conditions set by EC directives. Any acceptable tax would involve significant administrative work for a very large number of mainly small retailers; we do not think it could operate with the present number of different VAT levels. Although it would be a very collectable tax, there would be accountability problems accentuated by the scope, in a small country, for shopping across county borders.

4.3 For a local income tax similar administrative problems arise as a result of the method of collecting income tax on an income flow principle (rather than on an end year one as in many other European countries). We do not think it possible to contemplate the introduction of a local income tax simultaneously with pursuing the reforms to the national income tax system proposed by the Commission on Taxation. In addition, a local income tax (even if accompanied by a reduction in national income tax rates) would do nothing to widen the tax base nor permit a reduction in marginal tax rates.

4.4 A new form of property tax, based on capital values has, we think, much to commend it. We found a good deal of support for the principle in our discussions. To the general advantages of suitability and accountability which explain why in so many countries local governments levy taxes on property, we would add, in the specifically Irish context, the advantage of widening the tax base and thus bringing about a more equitable sharing of the tax burden in the economy as a whole. We therefore discuss a number of issues concerned with the

form a property tax might take, and how it could be administered. Subsequent to the completion of our work on this study, the Government announced its intention to introduce a "Farm Tax" (Building on Reality, 1985-87 especially paras. 6.16 and 6.17) and we have added a brief postscript about this proposal, paras. 4.89-4.92 below.

Sales Tax

4.5 For a local sales tax to provide an independent source of revenue for local government, each local authority would need to be able to set the level of tax in its area and collect the proceeds — either directly or using the Revenue Commissioners as its agent. A local sales tax has two very significant attractions, first it would be a buoyant tax and second it would be easily collectable in the sense of it being unlikely that there would be major problems of compliance.

4.6 However, any such tax would need to be acceptable to the European Commission which imposes constraints on the form that it can take. The EC, in its sixth directive on VAT, states that VAT must be charged uniformly throughout the land of any member state; it also prohibits any tax "which can be characterised as a turnover tax". It is not completely clear what this prohibition means; the ultimate arbiter of any interpretation would be the European Court, but no case has been tested there. Although some EC member states do have sales taxes, these were in place before the state signed the Treaty; derogations from EC rules have been easier to obtain on accession than subsequently. It is not possible for us to establish what the precise position is, that can only be a matter for Government. It is also worth noting that sales taxes do not constitute an important source of revenue for local government in any country of the EC — although they are commonly used by state and local governments in the United States.

4.7 Whether a sales tax would in fact be "characterised" as a turnover tax would probably depend on its structure. Our understanding is that it would be much more likely to be so characterised if it were levied at each stage in transactions. A single stage tax raised only at the final point of sale would be more likely to be acceptable: this would require it to be levied on the value of the sale not on the value added.

4.8 Two questions immediately follow. First, whether all traders should be registered for the tax. At present all traders have to register for VAT if their annual turnover is more than a fixed limit (IR£25,000 for goods, IR£12,000 for services). As a result there are very approximately 10,000 traders not registered compared with the 100,000 or so who are. A sales tax levied only at the final point of sale would produce

a larger competitive advantage for traders not registered (compared with those who were) than would an equivalent tax on value added. But to extend the net to the smallest traders could produce administrative complications and costs which many might have difficulty in handling.

4.9 The second question concerns the definition of the point at which the sale is "final". Most retailers sell goods both to individuals (a "final" sale) and to other retailers and businesses — usually small ones. The latter should not, in theory, be subject to the tax as there would be a risk of double taxation. But it would be difficult to design a simple system which enabled them to be excluded. Such problems would be particularly severe in the building trades.

4.10 A further problem is that the EC directive would seem to require that VAT be raised on the total value added, including any taxes. Hence the VAT percentage would need to be applied to whatever percentage the local authority set for its tax: the result would be a composite tax which would need to be expressed to two decimal places.

4.11 The coverage of the tax also needs to be considered in the light of the EC directive. The wider the range of goods and services to which the tax applied, the more likely would it be characterised as a turnover tax. But the narrower the range, the stronger would be the pressures for exclusion from it by various sectors of the economy, and the less the tax would help widen the tax base in the way which was discussed as desirable in Chapter 1.

4.12 The issue of coverage raises additional questions about the costs and administrative burden of a local sales tax. If the coverage were anything other than all goods and services (which it would have to be), then this would load a further significant burden on to the retailers. Of the six rates of VAT, the retail trade already has to deal with five (the 18% rate covers hotels) each covering a particular set of goods. There would be complications enough even if the local sales tax base were a combination of the bases for some of the existing five rates: if it cut across them the problems might be sufficient to cause severe breakdowns in the collection system.

4.13 We consider that retailers have shown a remarkable degree of resilience in being prepared to operate a multi-rate VAT. We gather, however, that the store of goodwill on the part of retailers may be nearing exhaustion. In view of the complications outlined above (none of which could be avoided) we have severe doubts about the practicality of seeking to add a local sales tax system on to the existing VAT

structure — no matter how it were administered.

4.14 The Commission on Taxation has recently produced its report on indirect taxation and has suggested that the number of VAT levels should be reduced, initially to two but with the objective of moving to a broad based single rate VAT as soon as possible thereafter. We understand the Government is broadly sympathetic to the proposals which would significantly reduce administrative burdens on retailers. We think that such a dramatic simplification would be a *sine qua non* for a local sales tax, although it would still not resolve the other problems outlined above (in paras. 4.8 to 4.11).

4.15 Furthermore, even if these other problems were resolved, a local sales tax does not score well on the major criterion of accountability for two reasons. First, the visibility of a local sales tax would not be high unless traders made a special point of showing the local tax as a separate item on any transaction. Without such visibility, accountability would be reduced.

4.16 But second, and at least as serious, would be the question of cross-authority shopping. With the increasing mobility of the population (mainly as a result of car ownership), people would tend to choose to shop in areas with a lower sales tax insofar as this were reflected in lower prices. Because many local authorities are relatively small, it would be fairly easy for many people to choose to shop in an authority in which they did not live. This would break the link with electoral accountability.

4.17 Such behaviour would be likely to be particularly prevalent in the general Dublin area, but also in those counties bordering Northern Ireland. (We are told that some people already drive North to take advantage of lower petrol taxes). This would also raise questions about whether "final sale" imports should also be subject to the tax and, if so, whether at the point of entry or of final destination.

4.18 In summary then, we think that the existing VAT structure precludes the introduction of a local sales tax. If, and only if, there were major changes to the VAT system, such as those proposed by the Commission on Taxation, could such a tax be possible although there would still be significant problems which would need to be resolved. Even then, it is not clear that such a tax would be acceptable to the EC, and furthermore its introduction would do nothing to widen the tax base — in fact, because the tax would probably need to be on a narrower range of goods than VAT, it might even narrow it.

4.19 Similar types of objections apply to local excise duties. For administrative reasons such duties are generally levied at the point of import or on the manufacturer. If these duties were to become local taxes, they would of course have to be levied at the point of sale, which would entail a very substantial increase in administrative costs (and increase the risk of loss of tax revenue through evasion). The problem of cross-border shopping may be even more severe with local excise duties in that, because levied on a smaller range of goods, differences in local revenue requirements would have a much larger impact on the prices of the goods concerned.

Local Income Tax

4.20 A local income tax scores well on the criteria we have suggested for evaluating possible new local taxes. In principle, an income tax bears the closest relationship to ability to pay, is consistent with strengthening local financial accountability and is capable of a substantial revenue yield. Local income taxes are common both on the Continent and in North America. It follows that the case for the introduction of a local income tax in Ireland must merit serious consideration.

4.21 There is, however, a serious difficulty in assessing the feasibility of a local income tax in Ireland at the present time, because radical reforms to the national income tax system are currently under consideration. The main, and generally recognised, defects of the present income tax are that its coverage is too narrow and that there are too many exceptions and allowances, with the result that the tax burden is not seen to be fairly shared and marginal tax rates are very high. The range of exemptions leads to economic distortions. The system is seen as unfair and inefficient.

4.22 The Commission on Taxation recommended, in its First Report in July 1982, a reformed income tax system characterised by the combination of a very broad tax base and a single, low rate of tax. In principle, the system which they propose would offer an equitable tax system, neutral in its economic effects, and with the advantage of administrative simplicity. Clearly, however, the task of widening the coverage of the tax and phasing out exemptions, even if offset by reductions in tax rates, is likely to raise tax burdens on some. The introduction of a single rate of income tax would open up the possibility of increasing the proportion of tax deducted at source. Indeed, one of the main features of an income tax system with a single rate of tax is that tax can be deducted at source without reference to the taxpayer's circumstances. One can tax the income flow without identifying the individual taxpayer.

4.23 In its 1984 Budget, the Government expressed its intention to follow the general principles recommended by the Commission on Taxation. The report of the National Planning Board in April 1984 made similar recommendations. We have ourselves been impressed by the degree of dissatisfaction with the income tax system and by the widespread recognition that reform is required. Nonetheless, the Commission's proposals have yet to be implemented, and there remains some uncertainty as to both the direction and the speed of income tax reform. Given the broad measure of support for the Commission on Taxation's proposals, however, it would seem to us wrong to advocate a local income tax at the present time unless it were also consistent with the Commission's general approach.

4.24 Studies of the administrative costs of local income tax, such as those carried out in the UK by the Layfield Committee in 1976 and more recently by the UK government for its 1981 Green Paper "Alternatives to Domestic Rates", have reached two main conclusions. First, that the costs of a local income tax which is administered and collected independently by the local authorities themselves without reference to the national income tax system are prohibitively high. Second, that if a local income tax is to be grafted on to the national income tax system, it is relatively straightforward if the national income tax operates on the basis of universal year-end assessments, but very costly if the national income tax operates on the basis of taxing income flows.

4.25 The "income flow" principle of income tax administration is unique to Ireland and the UK. The basic idea is that all flows of income — wages, salaries, dividends, interest, pensions etc. — are taxed "at source" in such a way that, by the end of the year, each taxpayer has paid the full amount of tax for which he (or she) is liable. In principle, for the majority of taxpayers no further action is required. For only a minority, for example those with high incomes or the self-employed, are individual assessments required. This system is familiar to most people in the form of PAYE, which is so designed to ensure that — subject to correct coding — each taxpayer's tax payment by the end of the year exactly matches his or her tax liability. In the UK, 85% of taxpayers on PAYE have their full tax liability deducted at source with no need for any year-end assessment; only about one-third of all taxpayers in the UK fill in an income tax return in any year.

4.26 To graft a local income tax onto this procedure it would be necessary for each employer to establish the place of residence of each of his employees and, in operating PAYE, use different tax tables and make different deductions for each according to where they live. Similar

arrangements would be necessary for deducting tax from pensions and other forms of income (such as interest on dividends). It is obvious that the administrative costs of such an arrangement to both employers and the taxation authorities would be very high.

4.27 Even so, and despite recognising and quantifying the high administrative costs, a system of the type described above was recommended for the UK by the Layfield Committee in 1976. But Layfield felt that because of the high administrative costs, local income tax in the UK was practicable only for the "major spending authorities" — that is, mainly upper tier authorities — and that it could not be extended to the lower tier authorities. In terms both of land area and of population, Irish counties and county boroughs are closer in size to British (post re-organisation) lower tier than upper tier authorities.

4.28 It should also be noted that Layfield proposed local income tax in addition to retaining a local property tax. It was thought necessary in the British context to have both taxes since the property tax alone could not be expected to raise sufficient revenue to finance the large proportion of local expenditure Layfield thought desirable. Had a local property tax been capable of a sufficient revenue yield, as would be the case in Ireland, it is doubtful whether Layfield would have recommended a local income tax.

4.29 We thus conclude that, with a national income tax administered on the "income flow" principle, the administrative costs of a locally variable income tax would be very substantial. There is no doubt that this is one of the reasons why Ireland and the UK stand virtually alone in not having local income tax. It seems to us that the arguments put forward by Layfield for a local income tax in the UK do not carry over to Ireland (and Layfield's recommendations for the UK have of course been rejected by successive UK governments).

4.30 The main difficulties and costs of grafting a local income tax onto a national income tax based on the income flow principle arise because there would be different tax rates in different localities. A simpler alternative would be to allow adjustments of the taxpayer's PAYE code by each local authority. Employers would then not need separate tax tables for their employees from different localities; the employee's place of residence would simply be one factor affecting his or her PAYE code. If local authorities were permitted to adjust the PAYE personal tax allowance, a local authority wishing to increase its spending might reduce the PAYE tax allowance of its residents by say IR£50. As a result they would all pay more in income tax (by the amount of

IR£50 multiplied by their marginal tax rate), and the Revenue Commissioners would then pass on the resulting additional revenue to the local authority.

4.31 While such an approach would have the advantage of administrative simplicity, this would, to some extent, be offset by the possibilities of confusion and conflict in having the PAYE personal allowances determined both by central and by local government. Central government might well wish to put controls on the freedom of local authorities to adjust the allowances; this would defeat the purpose of the arrangement which would be to provide a locally variable tax. Furthermore, we have doubts about the extent to which the tax would be visible to the local taxpayers.

4.32 If, on the other hand, Ireland had a national income tax system based on year-end assessment, the case for a local income tax would become much stronger. With such a system, local income tax is relatively straightforward to administer, as can be seen in practice in the United States, Canada, Scandinavia and other European countries. Under year-end assessment, each taxpayer is required each year to add together income from all sources, to subtract allowances and exemptions and to end up with a figure for total taxable income. There are then tax tables on the basis of which either the taxpayer or the taxation authorities can read off the taxpayer's liability. To graft a local income tax onto this system all that is required is for there to be different tax tables in each local authority, combining national and local tax rates. The tax continues to be collected by the national taxation authorities, with the local component being paid over to the appropriate local authority. (It may be noted that, even with a system based on year-end assessment, most tax is still deducted at source: the difference being that all taxpayers will complete a year-end assessment).

4.33 It has been put to us that, while in principle the Irish income tax system is based on the income flow principle, in practice, because the tax is complex with so many exemptions and so many marginal rates, many taxpayers, though still a minority, are already required to fill in income tax returns at the end of the year. Hence, it might be argued, the administrative and compliance costs of moving to a system of universal year-end assessment, with all taxpayers filing tax returns each year, might not be too great. (The need for universal coverage of assessments is first because they are the most convenient means of establishing the taxpayer's residence and second because, where tax is deducted at source, local variations in tax rates cannot always accurately be taken into account).

4.34 We are not persuaded by this argument. First, it seems to us that extending year-end assessment to all taxpayers would be a very substantial, and hence costly, administrative exercise; second, however, it seems to run counter to the general drift of the proposals made by the Commission on Taxation which would come close to eliminating the need for any year-end assessments. As we have noted (in para. 4.22) the effect of a single rate of tax together with a minimum of exemptions would be that tax can be deducted at source without reference to the taxpayer's circumstances. In terms of tax administration, a proposal to introduce universal year-end assessments for the purposes of local income tax would be in the opposite direction to the Commission's proposals.

4.35 Insofar as the Commission on Taxation's report provides the basic guidelines for the reform of the income tax system, it seems to us inappropriate to advocate a local income tax based on universal year-end assessments. If the Commission's proposals were to be implemented even in part the Irish income tax system would become more like that of the UK (and less like that in most other countries); it is for this reason that the British debate on local income tax is of particular relevance.

4.36 But even setting aside the aims of the report by the Commission on Taxation, we think there would need to be major changes in income tax administration before a local income tax system could be contemplated. We understand that the present arrangements are already overloaded, and that this is itself a source of serious inequity. The self-employed are in principle liable to income tax yet in practice few believe that they pay their fair share relative to those on PAYE. Many previously exempt farmers are now liable to income tax yet we gather that virtually no revenue has been collected from them. It seems to us that before the Revenue Commissioners were to embark on the additional work of universal year-end assessments and local income tax, these other problems need to be tackled.

4.37 Finally, we record that a standard objection to the introduction of local income tax in Ireland is that marginal income tax rates are already too high and a local income tax would increase them further. This was, for example, one of the main points made against local income tax by Copeland and Walsh in their 1975 study. On balance Copeland and Walsh regarded local income tax quite favourably, but they did not go into much administrative detail and in our view underestimated the administrative costs. As we have stated earlier, we regard any new local tax as substituting for some of the national tax take,

rather than adding to the total tax burden. Thus, if local income tax were to be introduced, we would expect it to be accompanied by a corresponding reduction in national income tax (and central government grants to local authorities). In principle, therefore, marginal income tax rates need not rise. Even so, a local income tax would not permit a reduction in marginal income tax rates, nor would it help to widen the tax base.

4.38 There are many other secondary detailed administrative problems with local income tax, for example how to treat people with two homes or people who move from one local authority to another. But, as we have already noted, there are local income taxes in many countries so that in general there can be no insuperable difficulties in dealing with such problems; they are detailed points and hence not crucial to a decision in principle about local income tax.

A New Property Tax

4.39 All the major countries of Western Europe have some form of property tax, as do the United States, Canada, Australia, New Zealand and Japan. The yield of the tax varies significantly between countries: in the UK, property taxes raise nearly 13% of total tax revenue, while at the other extreme in Sweden they raise less than 1% (according to OECD figures for 1981). Although in all countries there are various concessions and exemptions, Ireland is the only country where dwellings are generally exempt from the tax, and Ireland and the UK are the only countries where agriculture is exempt.

4.40 In abolishing rates on dwellings and on agricultural land, Ireland has thus become the odd man out. The more recent introduction of a residential property tax (on properties valued at over IR£65,000) accruing to central government, and of water and other service charges (assessed in some places on the basis of rateable value and accruing to local authorities) suggests, however, that the public finances are finding difficulty in doing without the revenues a property tax can bring in. Indeed, given the strains on the Government budget to which we have already referred, the possibility of widening the tax base by restoring some form of property taxation must merit serious consideration.

4.41 When domestic rates were abolished in 1978 they had become unacceptable because they had become inequitable, there was no relationship between rate bills and ability to pay and they were seen as an unfair tax. There were four reasons why domestic rates had come to have little relation with ability to pay. First, the absence of a general revaluation since the "Griffiths" valuation of 1852 had meant that

rateable values did not correspond with the relative values of different properties. Second, there were various exemptions in relation to new buildings and improvements. Third, there were differences in rate poundages across local authorities, which appeared to have little to do with differences in provision of services but were in part explained by the absence of any "equalisation" provisions in the grant system. Thus one might have two families living in houses of identical value paying quite different amounts in rates — in part due to lack of uniformity in valuation and in part due to different rate poundages being levied in different authorities. These inequities all resulted from the way in which rates, and the grant system, had been administered in Ireland; none of them are intrinsic to property taxation.

4.42 The fourth reason why domestic rates were thought unfair is, perhaps, the most serious. It is that rates were a tax on property and the value of the property a person lives in may bear little relationship to his ability to pay. There were, of course, discretionary powers for local managers to relieve "necessitous persons" from rates, but there were no systematic national schemes for rate rebates or reliefs (such as those set up in the UK after the Report of the Allen Committee in 1966).

4.43 In the case of agricultural rates, on the other hand, the most serious deficiency was that of the valuation process itself. Agricultural valuations were still based on assumptions about land usage and product prices which had been made in 1852 and had become in some cases almost the reverse of current productivity. Various exemptions and reliefs for farmers had also been introduced, in addition to the Agricultural Grant paid in place of rates which effectively exempted small farmers.

4.44 These defects in the rating system were serious, and it is only worth considering a new form of property tax if it can avoid these problems. We think that is possible, and indeed that the abolition of domestic rates provides an opportunity for a radical redesign of the property tax system without being encumbered by the particular features of an existing and unsatisfactory system. In designing a new system from scratch one can take account of strengths and recognised weaknesses of property taxes operating in other countries.

4.45 In designing a property tax there are six major issues requiring discussion. They are:

- (a) coverage
- (b) the tax base

- (c) valuation procedure
- (d) tax relief for those in need
- (e) whether the tax should be allowable against income tax
- (f) the residential property tax.

There are of course many less strategic issues, such as exemptions and concessions, arrangements for payment and so on. These latter issues are unlikely to influence the decision whether or not to introduce a new property tax and we will therefore not pursue them in detail.

(a) *Coverage*

4.46 A comprehensive property tax would be a tax on land and buildings in all uses. It would tax dwellings, commercial and industrial property, farmland, public buildings and all other immovable structures. A partial property tax would have a more limited coverage. For example, there might be a tax on land but not on buildings, or else a tax confined to certain sectors or uses of property.

4.47 A land tax is more narrowly based than one on property, therefore needing higher tax rates to produce the same yield. Its main advantage is that it encourages the development of land to its maximum potential. A tax on buildings necessarily implies that development of a property attracts a higher tax bill. Were one designing the national tax system from scratch in an ideal world one might well not want a tax on capital investment in property over and above a comprehensive tax on investment income. (This line of argument has indeed been put forward by the Commission on Taxation.) In practice, few tax systems come anywhere near this theoretical ideal and it may be unwise to assume that Ireland would be an exception. In the present tax system some forms of property — in particular housing, both owner-occupied and local authority dwellings — are heavily subsidised relative to other forms of investment. It would thus reduce, rather than increase, distortions if such buildings were brought into a property tax net.

4.48 If a land tax were levied on site value it would be necessary for each property to separate the value of the site from the value of any development on it. While this is not impossible — land taxes based on site value operate in Australia and New Zealand — it clearly involves some unverifiable hypothetical assumptions and adds significantly to the costs and difficulties of the valuation process.

4.49 A tax base on land acreage would in practice be a tax on farming. While we appreciate that there is a strongly held view that some farmers pay insufficient in tax relative to other members of the com-

munity, an acreage tax is not a satisfactory answer to this problem. Some farms are very much more profitable per acre of land than others. An acreage tax taking no account of differences in productivity would be likely to drive the poorer farmers out of business altogether even at quite low rates of taxation. In The Netherlands, the Polder Boards (which are responsible for drainage, dykes etc.) levy a tax on the acreage of unbuilt land, but the revenues from this tax are small, and there is in any event much less variation in land values in The Netherlands than in Ireland.

4.50 On balance, therefore, we think the disadvantages of confining a property tax to land outweigh any advantages. In Europe and North America property taxes are levied on both land and buildings, and we think any new property tax in Ireland should follow this pattern.

4.51 The other major question with coverage is whether any major sector of the economy should be exempt from the tax. It is natural to want to minimise exemptions, both because they can lead to economic distortions and because in the outcome they will often appear inequitable. We have already noted that the previous rating system was characterised by many exemptions, and that this may have contributed to the feeling that the system was unfair. It seems to us therefore that there is everything to be said for taking as a starting point the principle of a comprehensive property tax, to be levied on land and buildings in all sectors of the economy.

(b) *The tax base*

4.52 There are three possible bases for a property tax: capital value, annual (rental) value or some measure of area such as floorspace (or land acreage, but see paragraph 4.49 above).

4.53 A tax on floorspace could be levied both on households and on industry and commerce. Like the tax on land acreage, it would bear little relationship to ability to pay. Luxury flats in the city centre might pay less than basic council houses, and head offices less than factories. Some municipalities in The Netherlands make use of square footage in property tax assessments but only as part of a mechanism for calculating approximate (capital) values of property.

4.54 The basic choice is thus between a tax based on the capital value of the property or one based on the value of the annual rental income. Outside Ireland, of the main countries operating property taxes only three (Spain, France and the UK) use a rental value base. In one of these three, the UK, there is a unanimous view among all the profes-

sional bodies concerned with valuation that a move to capital valuation is desirable or even essential if a general revaluation is to take place.

4.55 The case for a capital valuation basis does not appear as overwhelming in Ireland as it is in the UK, however. Rent controls have now been abolished for some dwellings, and in some areas (particularly in Dublin) there is an active rental market. For many classes of commercial property, renting remains the most common form of tenure. Those professionally involved in valuation are confident that it would be possible to undertake a general revaluation on a rental basis.

4.56 Even so, there seems to us a strong case for capital valuation. The proportion of households in the owner-occupied sector is now about 75%; the remainder are renting either privately or from local authorities. Clearly, therefore, for most households, capital value is something of which they have direct experience. People take an interest in the prices which properties in their area fetch when sold, and have an idea of the market value of their own house. By contrast, for most people, the rental value of their house has no real meaning. With capital valuation the basis of valuation would be better understood and hence the tax itself perceived as more equitable than would be the case with rental valuation.

4.57 Similar considerations apply to agriculture, where renting is unusual. While for commercial property renting is the most common form of tenure, we are informed that there is adequate evidence of sales to support a valuation of commercial premises on the basis of capital values.

4.58 The main objection to capital valuation is that capital values of property tend to be more volatile than rental values, so that uniformity of assessment is more difficult to achieve. There is, however, a great deal of experience in operating assessment systems based on capital valuations both in the United States and in many European countries (such as Denmark, Germany and Sweden). In these countries, as in Ireland, there is a mix of owner-occupied and rented housing. Yet as far as we know in none of these countries is there serious dissatisfaction with capital valuation nor any pressure towards shifting to a rental valuation system.

4.59 On balance, we would favour a system based on capital valuation to one based on rental values.

(c) *Valuation procedure*

4.60 There has not been a general revaluation since 1852, and naturally the administrative mechanism to produce a complete new valuation list is not in existence. If such a valuation were entrusted to the Valuation Office, it would clearly represent a large administrative task which would take many years to organise let alone to implement. The Valuation Office, to take but one practical point, has at present no local office outside Dublin. Such a general revaluation could thus only be regarded as a long-term solution.

4.61 However, in an imperfect world, valuations to the high standard of accuracy and consistency which the Valuation Office would produce may be regarded as something of a luxury especially in present circumstances where reforms that can be implemented relatively speedily are being sought. A number of methods might be considered which could offer less precise valuations, but nevertheless give results sufficiently close to the value of a property to avoid any serious inequity. One possibility would be to allow local authorities to commission local estate agents to produce a valuation list on the basis of their experience of recent sales and of relative property values in their locality. There would need to be a system of "banding" with the assumption that the local estate agent would be able to place a property in the right "band" of values in most cases at sight. Clearly there would have to be procedures to prevent abuse, and to allow appeals.

4.62 An alternative, and in many ways more radical, suggestion would be to do away with valuations for most properties. People could simply be taxed on the price they paid for their house, perhaps updated according to a property price index. In California, properties are valued at the greater of:

- their assessed capital value in 1975 updated at a rate of 2% per annum;
- their most recent purchase price, if post 1975, also updated at a rate of 2% per annum.

In practice property values in California have risen much more rapidly than 2% per annum with the result that selling a house tends to raise its assessment value for property tax significantly. This problem could, however, have been avoided by updating the valuations by an index related to the actual appreciation in property prices.

4.63 If such a system were introduced it would initially be necessary to rely on a degree of self-assessment. Each householder would be asked how much they paid for their house and when they bought it. If the

system were to continue in operation, however, actual market values could be fed into it. Information on the market price of each transaction is already required by the authorities for stamp duty, and this information could be passed on to the relevant local authority.

4.64 It seems to us that while we have not set out a complete blueprint for such a system, valuation based on market sales rather than "notional" values may merit consideration as a permanent procedure. Clearly, a full appraisal of valuation procedures would require a much more detailed and more specialist study than we have been able to undertake. We have already noted that almost every country in the developed world operates a property tax (as indeed do many less developed countries). We are confident that there are no administrative reasons peculiar to Ireland why such a tax should not be introduced if thought desirable.

(d) *Rebates*

4.65 One of the strongest criticisms of domestic rates was that the rates payable bore no relation to the ability of the ratepayer to afford them. Income tax overcomes this problem directly, VAT is (and other sales taxes would be) indirectly linked to ability to pay as it is a tax on, and rises with, consumption – furthermore many necessities are not eligible for VAT. Rates might have been considered as a tax on the consumption of housing, but housing – or at least some basic level of it – is a necessity and also the rigidities within the housing market make it much more difficult to adjust consumption as income varies.

4.66 If therefore, housing were to be used as the basis for a property tax, some facility would be needed to assist poorer households. Under the previous rating system this facility existed as local authorities could waive rate payments for those they considered to be "necessitous" persons. However this facility was at the discretion of local authorities and we understand there were wide local variations – despite central guidelines. The net effect of exercising the discretion was to increase the rate bills for other ratepayers; furthermore as it was a simple waiver rather than a sliding scale, it created poverty trap problems.

4.67 We think that a new capital based property tax should, on the grounds of fairness, only be implemented if it were accompanied by an efficient rebate scheme. There are five critical components in the design of such a scheme.

4.68 First, the rebate should not be connected simply with the value

of the property, but rather to the payer's income and tax payable. The view was put to us that it would be administratively simple to exempt all properties whose capital value fell below a set limit. There is no doubt this would be simple administratively, but it would not serve the purpose for which a rebate system is intended. Not only would some low value property be occupied by better-off households, but, at least equal concern, some poorer households occupy higher value property – the classic example of the latter is the elderly widow who continues to live on in the family house after her income has dropped.

4.69 The second important principle is that, as any rebate scheme would have a redistributive rationale, the shape of the scheme itself and the funds to support it should be the responsibility of the central government. It would be inequitable for an authority with a high proportion of poorer households to have to finance a rebate system through higher demands on the rest of the population – although there may be a case for a small proportion of the costs to be met locally in order to encourage efficiency in its operation.

4.70 At first sight it might appear that a rebate scheme would put yet a further burden on the Exchequer; this need not be the case. It would be quite possible for the scheme to be funded from the total budget which the Government wished to make available for local authorities. Any demands to finance the rebate schemes could be balanced by reduction in the funds available for general support for local authorities under a non-specific grant scheme (see Chapter 5).

4.71 The third principle would be more difficult to implement – indeed it may be impossible. Any scheme to redistribute resources within the country should be considered in the context of overall policies on taxes and benefits. The disadvantages of considering each component piece in isolation is that it can produce, unintentionally, very high marginal tax rates at relatively low incomes. The only sure resolution of this problem would be to design a single system embracing tax credits and/or negative income tax. Such arrangements are well outside the scope of this study, we were given no indication that such proposals were even on the horizon.

4.72 Considering the rebate scheme in isolation, then, the fourth principle is that the scheme should seek to minimise the creation of any poverty (or unemployment) traps. For this purpose any system involving a sliding scale for rebates is to be preferred to one involving an all-or-nothing approach determined by an eligibility criterion (e.g. those in receipt of Social Welfare). The simplest approach would be to set

minimum household income (e.g. the Social Welfare level) below which all the property tax was met by a rebate, with the rebate reduced by, say, 20 pence for each £1 above the minimum. The actual figures should be determined by the expected incidence of other taxes on incomes at these levels.

4.73 As an example, however, the minimum household income might be set at, say, IR£2,000 per annum. All households with a total income of IR£2,000 or less would thus be completely exempt from property tax. If the rebate were reduced by 20p for each pound of income, a household on an income of IR£2,100 would be liable to a maximum property tax bill of IR£20, a household on an income of IR£2,200 to a maximum property tax bill of IR£40 and so on, the remainder of the tax being met by the rebate scheme. The intention is that most households on average incomes would be outside the rebate scheme: for example, for a household with an income of IR£6,000 the maximum property tax bill would be IR£800. We would expect most households on average income to face a property tax bill significantly lower than this amount, and so the rebate scheme would not apply to them.

4.74 The final point concerns the administration of the system. The difficulties with any means tested scheme are the administrative problems associated with establishing income levels. A mechanism does already exist for this in connection with the determination of local authority rents and we see no reason why this should not be extended. The effect of the arrangement would be that local authorities would be acting as the agents of central government for the rebate scheme. We think this would be preferable to setting up new arrangements through, for example, the Social Welfare Offices.

(e) *Property tax as an allowance against income tax*

4.75 There are two ways in which a property tax can be set against income tax. The first, "crediting" it against income tax, means that a property tax bill of, say, IR£100 reduces income tax liability by that amount. The second, that of "allowing" it against income tax means that a property tax bill of IR£100 reduces taxpayers' income assessable for tax by that amount. Thus, if property tax is credited against income tax, its effective burden on income tax payers is zero. If it is allowable, then its effective burden depends on the taxpayers' marginal rate of tax: the higher the marginal rate (i.e. the higher the income), the lower would be the effective burden of a property tax.

4.76 In many countries, including Ireland, Germany, Japan, The Netherlands, Sweden and the UK, property taxes are allowed against

corporate or individual income tax. The rationale for such deductions is not always clear. One approach, which is followed by the Commission on Taxation, is to regard property tax as a form of implicit income tax on the income generated by the property. Where such income is already subject to taxation, as in the corporate sector, a further tax on the same income cannot be justified. Hence the Commission recommends a complete crediting of commercial and industrial rates against income tax.

4.77 No country, as far as we are aware, follows the Commission's approach to the extent of crediting property taxes in full against corporate income tax. Such an approach would not affect the basis of accountability as this relates primarily to domestic property. To the extent, however, that commerce and industry pay tax, levying a property tax upon them and then allowing it as a credit against income tax produces no net revenue. It would be simpler and more logical to exempt commerce and industry from the property tax. On the other hand, if the coverage of the income tax is incomplete, and unsatisfactory coverage is expected to remain a feature of the income tax system, the crediting arrangement could be said to provide a "backstop" method of taxing enterprises that are not caught in the income tax net without adding to the burdens on those which are.

4.78 An alternative approach is to regard local taxes as the price paid for goods and services provided by local authorities. On this interpretation, commercial and industrial rates can be regarded as a business cost, like rent or wages, which can therefore be deducted from gross income to arrive at a figure for profits or net income, which would then be liable to taxation. On this interpretation also, there would be no reason to allow domestic property tax against individual income tax, any more than one would allow household expenditure on food or rent as an allowance against income tax.

4.79 The case for regarding property tax payments by commerce and industry as an allowable cost appears to us to be a strong one. It seems clear enough that such tax payments would constitute an operating cost of an enterprise and that the appropriate basis of business taxation is profit or net income after deduction of operating costs. The argument that local authorities provide services for local industry and commerce is one reason for including such properties in the local tax base.

4.80 On the position of individual households, it would clearly make no sense to allow a general crediting of property tax against income

tax, for that would mean the effective burden would fall on central government. Only local residents who pay no income tax would suffer any net increase in their tax burden as a result of a change in the local property tax. Hence a system of general crediting would undermine, if not destroy, the whole basis of accountability in a property tax system. Correspondingly, there would be no incentive for local authorities to restrain their expenditure if they knew that, for the majority of their citizens, any higher local taxes would simply be offset in full by a reduction in central government taxes.

4.81 The position on whether property tax should be allowable against income tax is less clear cut. The position in other countries is somewhat confused. Property taxes are not allowed against individual income taxes in some countries such as France, Germany and the UK where the imputed income from housing is not taxed. In The Netherlands and Switzerland the imputed income from housing is taxed and property tax payments are allowed against such income. However, in yet other countries including the United States, the imputed income from housing is not taxed and yet property taxes are nonetheless allowable against personal income tax.

4.82 For any government introducing a new tax, such as a new property tax, it is very important to make the change as attractive as possible. The introduction of a new property tax could allow substantial reductions in the marginal rates of income tax and/or improvements in income tax allowances. Such reductions in tax can be made by government to balance the extra revenue generated by the new tax. Alternatively, if a new property tax is allowable against individual income tax, much of the net revenue gain would be aborted, thereby precluding the possibility of more general reductions in the levels of income tax.

4.83 But there are arguments both for and against allowing a property tax against income tax. In principle there is no case for allowing property taxes against individual income tax, any more than, say, VAT payments or capital gains tax should be allowable against personal income tax. The effect of such an allowance would be to make it bear heavily on those who pay no income tax, but rather lightly on those with high marginal tax rates. Whilst no doubt some people who pay no income tax could afford to do so, most people who pay no income tax are poor. A property tax allowable against income tax would thus fall most heavily on those least able to afford it; this would be inequitable.

4.84 Secondly, the perceived inequities in the present income tax

system strengthen the case for taking advantage of the new source of revenue to make a general reduction in income tax rates. Allowing property tax against income tax would simply add further (inequitable) distortions into the system rather than reducing those that are already present. Allowing a local property tax against income tax would run counter to the approach of the Commission on Taxation to simplifying the income tax structure.

4.85 Third, there are accountability reasons for not allowing property tax against individual income tax. Such an allowance would mean that in effect, a significant part of the costs of local government spending would be borne not by the local community but by central government. If local authorities wish to have discretion over their overall spending levels, they must, as we have argued in Chapter 2, be responsible for raising the money to pay for such spending. Further, central government would be aware that local taxes would "eat into" the potential revenue from national income tax, and for this reason might wish to take powers over local taxation levels to protect national tax revenue.

4.86 On the other hand, however, there would be presentational advantages in making a new property tax allowable against income tax. There are two reasons: first, at the national level it would be clear that there had been a reduction in the total burden of income tax — the Government would not be able to obscure the point. Secondly, at the individual level, households would be able to perceive a direct and personal link between the introduction of a new property tax and a reduction in their own personal income tax.

4.87 Such presentational advantages would clearly be of some importance to a government seeking to bring in a new tax. However, they have to be set against the disadvantages of the inequity, distortion and blurring of accountability that such arrangements would produce. The balance is one of expediency and acceptability against logic; some of the existing problems of Irish local finance stem from that balance having been tipped too far away from logic. There is no doubt that the introduction of a new form of property tax would be an act of political difficulty; we think there would be more advantage if it were done in a way which helped resolve some of the inequities in the present income tax system rather than adding to them.

(f) *The residential property tax*

4.88 A new property tax for local government based on capital value would overlap the present central government tax on properties valued at over IR£65,000. It seems to us that it would be confusing to tax

payers as well as risking conflict between central and local government if both were to levy a tax on the same basis. Our assumption is that the residential property tax would be abolished, the new property tax taking its place as a means of collecting tax from high value properties. The abolition of the residential property tax would in principle absorb some of the revenue to be derived from a new property tax, although we gather that, to date, very little revenue has been collected from the residential property tax.

Postscript: The New Farm Tax

4.89 Since the completion of the work for this study, the Government has proposed a new local tax to be levied on farms in proportion to their adjusted acreage (Building on Reality 1985-87 paras. 6.16 and 6.17). In the context of the arguments put forward in our report, it seems to us this proposal should be welcomed, both in its recognition of the need for a stronger local tax base and for its effect of widening property taxes.

4.90 With regard to the Farm Tax as currently described, a number of points arise immediately. First, the tax bears some resemblance to the "Resource Tax" on agricultural land which was introduced and then immediately abolished in 1980/81. The merits and defects of this tax, in general terms, have been discussed by the Commission on Taxation in its Second Report (Chapter 10). The decision to assess farms on the basis of acreage adjusted for productivity may have advantages in terms of administrative convenience and perceived objectivity compared with a system based on assessed rental or capital value (though the Commission on Taxation did not endorse this argument). On the other hand, it risks being regarded as arbitrary and inequitable to the extent that the adjustments made for productivity do not fully reflect differences in farmers' incomes. Perhaps more serious from the standpoint of the property taxation system as a whole is the problem that assessing farms on a basis different from that for commerce and industry may impede rather than encourage the further extension of the property tax to dwellings. Taxing different types of property in different ways can lead to anomalies and distortions.

4.91 The tax harks back to the earlier basis of valuing farm properties for rating which has now been judged unconstitutional. It is important to stress that regular revaluations (to take account of changes in the relative productivity of different types of land and of movements in product prices) will be as important for the method of valuation proposed as with any other form of rating.

4.92 Though not stated explicitly, it appears that the Government envisages that the rate at which the Farm Tax is to be charged will be set centrally (though the tax will be administered and collected by local authorities). If so, it must be recognised that the tax can do nothing to increase local government's powers to determine its level of spending nor to enhance local accountability. The tax will simply provide local authorities with one centrally determined block of funds (the Farm Tax revenues) in place of another (the grant in relief of rate on agricultural land). It might appear anomalous for the rate of Farm Tax to be determined centrally, while rates on commercial and industrial properties are determined locally.

CHAPTER 5

CENTRAL GOVERNMENT GRANTS

5.1 It is impossible to discuss the design of a grant system in isolation. The purposes grants serve relate directly to other aspects of the local government financial system. At one extreme, if grants provide 100% of local government finance, decisions on grant become identical to decisions on local authority expenditure made by central government not only in aggregate but for each local authority and, possibly, for each service as well. At the other extreme, if local authorities rely for the bulk of their finance on local taxation, the main function of a grant system might be to provide resource deficiency grants to assist local authorities whose local tax base is low.

5.2 In Chapter 2 of this report we suggested that the Irish system faced a choice between developing into an almost entirely grant financed system or introducing major new revenue sources in the form of either a new local tax or very much more widespread use of charges. In this chapter we will examine the implications for the grant system of these two options separately.

A Grant Financed System

5.3 In examining the feasibility of a system based almost entirely on grant finance, it is instructive first to examine international experience. In most countries local authorities raise significant amounts of revenue from local taxes; the only country where local authorities are substantially dependent on central grants is The Netherlands. It may therefore be useful to describe briefly the system in The Netherlands.

5.4 Local authorities in The Netherlands are responsible for a wide range of services including education, police and social welfare. They are also responsible for urban development, road maintenance and street lighting, refuse collection, planning, recreation and amenities, libraries and various other services. They therefore carry out most of the services provided by local authorities in Ireland, but have major additional responsibilities.

5.5 The grant to local authorities is paid out of the "Municipal Fund". The amount paid out each year is determined by the decision of central

government Ministers, who are, however, required to listen to the recommendations of the "Council for Municipal Finance" which is an advisory body representing the local authorities.

5.6 The grants paid to local authorities from the Municipal Fund are of two kinds. First, there are general or block grants which local authorities are free to spend on whichever services they wish, and which are allocated on the basis of a formula taking into account various "objective" characteristics of the local authority. Secondly, there are specific grants related to the costs of particular services which of course have to be spent on the services for which they are provided. About one-third of the grant money is paid out in the form of general grant and about two-thirds in the form of specific grants.

5.7 The formula on which the general grant is paid out is again based on the recommendations of the "Council for Municipal Finance". At present the formula relates the grant to seven "basic" factors. Of the seven, the most important, amounting to over half (54%) of the total grant is an amount related to the number of dwellings on a seven step scale. The other main factors are the authority's population (17%), its land and water surface area, its built-up area (9%) and the average height of buildings in urbanised areas. (The measurement of these last two factors is highly technological: it makes use of aerial photography and stereo mapping using laser beams). The factors in the formula have been determined from a study of the spending patterns of local authorities. Then various "adjustment factors" are applied relating to social structure and a number of special factors. This grant formula is clearly designed for the particular circumstances of The Netherlands but it does indicate that it is possible to operate a block grant based on spending need without running into the interminable complexity of formulae such as those at present used in England and Wales.

5.8 Even so, in The Netherlands there has been a large increase in specific grants, which relate to areas of expenditure where costs of services are unequal between authorities and for which it is difficult to devise general formulae. The main services to which specific grants apply are education, police, social welfare payments, urban development and public transport.

5.9 A final point to note is that local authorities in The Netherlands retain the power to determine a local property tax. Though the tax provides only a very small proportion of local revenue, it does still permit a degree of local discretion at the margin in relation to overall spending.

5.10 If one were to introduce in Ireland a grant system similar to that in The Netherlands, the main features might be:

- (a) to retain specific grants for services such as housing and national roads (i.e. "national" services) and perhaps also for debt service on some other capital outlays where policy is laid down by central government which determines the standard of service provision and hence the level of expenditure; and
- (b) to introduce a general or block grant to cover other services so that each authority would receive an allocation related according to a formula based on its population, road mileage, land area and so on, which would replace the existing agricultural grant, the grant in relief of domestic rates, and the existing block grant for roads. The purpose of the block grant in this context would be to allow local authorities discretion over the way in which the funds are spent, and to be answerable to the local electorate for how they allocate their budget.

5.11 There seems little pressure in Ireland to introduce reforms to the grant system. At first sight this may appear strange, since one might think there would be little systematic relationship between a local authority's rateable value (upon which its grant is based) and its financial needs. However, the grant paid to each authority depends not only on its rateable value but also on the rate it levied in 1977. In Table 9 we show the rateable value per head in each county in 1977. There is a high degree of uniformity with all but four counties (and one county borough) being in the range £5.00-£7.00 per head. The only county above this range is Meath, and its rate poundage in 1977 was unusually low (as shown in column 4 of Table 9). Three counties, Donegal, Kerry and Mayo (all on the west coast) have exceptionally low rateable values per head, and as Table 9 shows, the rate poundage levied in those counties was very high. Thus differences in rate poundages have tended to offset inequalities in rateable value; column 5 shows the relatively small variation in rates per head (from IR£39 in Kildare to IR£67 in Dublin). To the extent that low rateable values on the west coast reflect low incomes, the system is inequitable in that rate poundages are highest where incomes are low.

5.12 Similarly we imagine that where spending needs were high local authorities levied higher rates. Thus, in effect, the grant in relief of domestic rates has become a "needs grant" where the spending need of each authority is measured by its actual expenditure in 1977. In the short run, past expenditure is often a relatively good measure of spend-

ing need and this may perhaps explain why there is relatively little dissatisfaction with the present grant system. With the passage of time, however, 1977 expenditure seems likely to become an increasingly unsatisfactory basis for grant allocation.

5.13 It appears to us that it would be possible to design a block grant related to spending need for the majority of the services for which local authorities are responsible. The present grant is an adequate stopgap, but cannot last for ever. There is, however, sufficient time to allow proper study and careful design of a block grant system.

5.14 The same conclusions would seem to us to follow if the present system retaining non-domestic rates were to continue. Whether as a result of central controls or of consensus among local authorities, the increases in non-domestic rate poundages have been, and are likely to continue to be, similar across authorities. As relative spending needs of authorities diverge from what they were in 1977, it seems likely that other methods of financial adjustment will be adopted, rather than that significant differences in non-domestic rate poundages will be introduced. In a block grant system, the grant allocation to each authority could therefore be adjusted to allow for the non-domestic rate receipts on the assumption of a common rate of increase of poundages for non-domestic ratepayers.

A Tax Financed System

5.15 If local authorities are able to levy local taxation, it is clearly necessary first to ask why, or in what circumstances, such tax revenues need to be supplemented by central government grants. In some countries, of which a prime example is perhaps the UK, the scale of local government expenditure is substantially greater than the revenue that can reasonably be raised from the local tax sources and a substantial grant payment is required simply to fill the gap. In Ireland, the scale of local authority expenditure is smaller and a new local tax, such as for example, a new property tax, might well have sufficient revenue potential to finance the bulk of local government spending.

5.16 There are two other substantial arguments for the provision of central government grants. The first relates to services provided by one local authority which benefit people living in other local authorities. A good example is the road network. Some roads in a locality may be used primarily by through traffic, and the residents of the locality may be unwilling to pay (through local taxation) for the upkeep of such roads which are of little benefit to them. Specific grants are appropriate in this context, the size of the specific grant depending on

the extent to which the local authority is providing a national rather than a purely local service.

5.17 Of the services provided by local authorities, roads are the most obviously "national" service in this sense. The present system for grants in relation to road expenditure, which distinguishes between national and local roads and provides 100% specific grants for the former and partial specific grants for the latter, appears in general terms well designed for this purpose.

5.18 The other major purpose of grants is that of equity, or equalisation. The idea here is that individual households should not have to pay very different amounts in local taxation because they happen to live in local authorities where spending needs are particularly high or where local taxable resources are low. In most European countries, in the United States, Canada and Australia, equalisation has been made an explicit objective of the grant system; in Switzerland it forms part of the Constitution, in West Germany it is Federal Law.

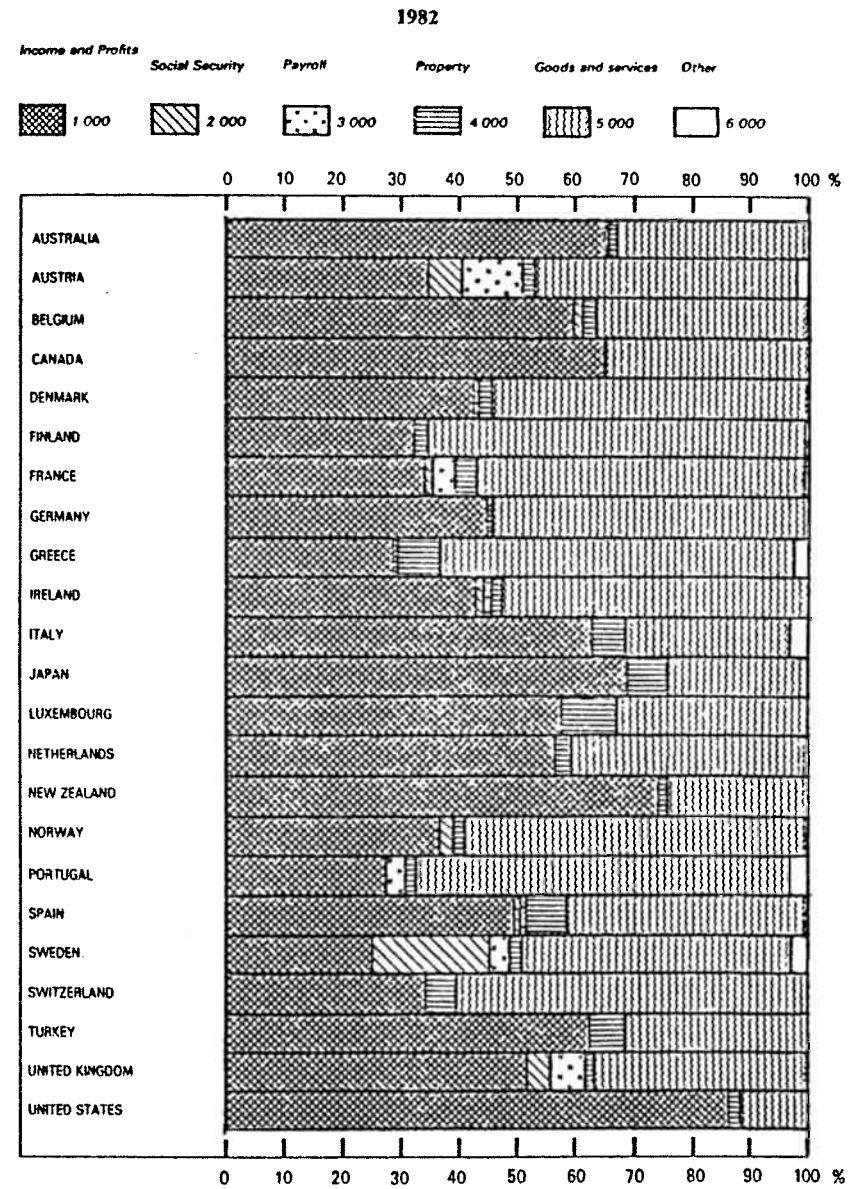
5.19 In Ireland, by contrast, the grant system has never been designed to achieve equalisation. The need for equalisation grants is perhaps less than elsewhere in part because, as already noted from Table 9, rateable values per head are fairly even across the country; in part also, many of the expenditure functions of local authorities (such as refuse collection) are relatively similar in their costs per head, and those services where costs are not similar, such as housing, are heavily supported by specific central government grants. It may, however, be argued that it is the absence of an equitable general grant system that has led to extensive reliance on specific grants which have themselves contributed to undermining local government autonomy.

5.20 In the design of a grant system to accompany any new local tax, it seems desirable that the objective of equalisation be more explicit. The revenues derived from a new local tax will not necessarily accrue equally across authorities. Central grants should be provided to authorities where the local tax base is small. The grant should also take into account spending need (as described in the first section above). Most countries have grant systems designed along these lines and we see no technical or administrative reasons why the same should not be done in Ireland. Such a grant could absorb the existing rate relief grants, block grant for roads and some specific grants, e.g. for sanitary services. Because in its construction it would take into account differences in spending needs between authorities it would take over the function of the existing grants in allocating more funds to areas of greater need.

5.21 In a system incorporating a new property tax it seems unlikely that the local tax base would be as uniform across the country as were rateable values per head of population under the previous system. We would expect there to be a much higher tax base in Dublin and in the other large towns than in the rural counties, in part as a result of differences in property values and in part as a result of the location of commerce and industry. The function of a grant system would be to limit the geographical inequality of property tax rates, so that households (or firms), wherever located, might expect to pay around say 1 or 2% of the capital value of their property in tax each year.

CHART II

The composition of central government tax receipts¹



1. This refers to only those taxes which are classified as central government taxes. Social Security contributions paid to social security funds are excluded.

Source: Revenue Statistics of OECD member countries 1965-83

Taxation as % of GDP

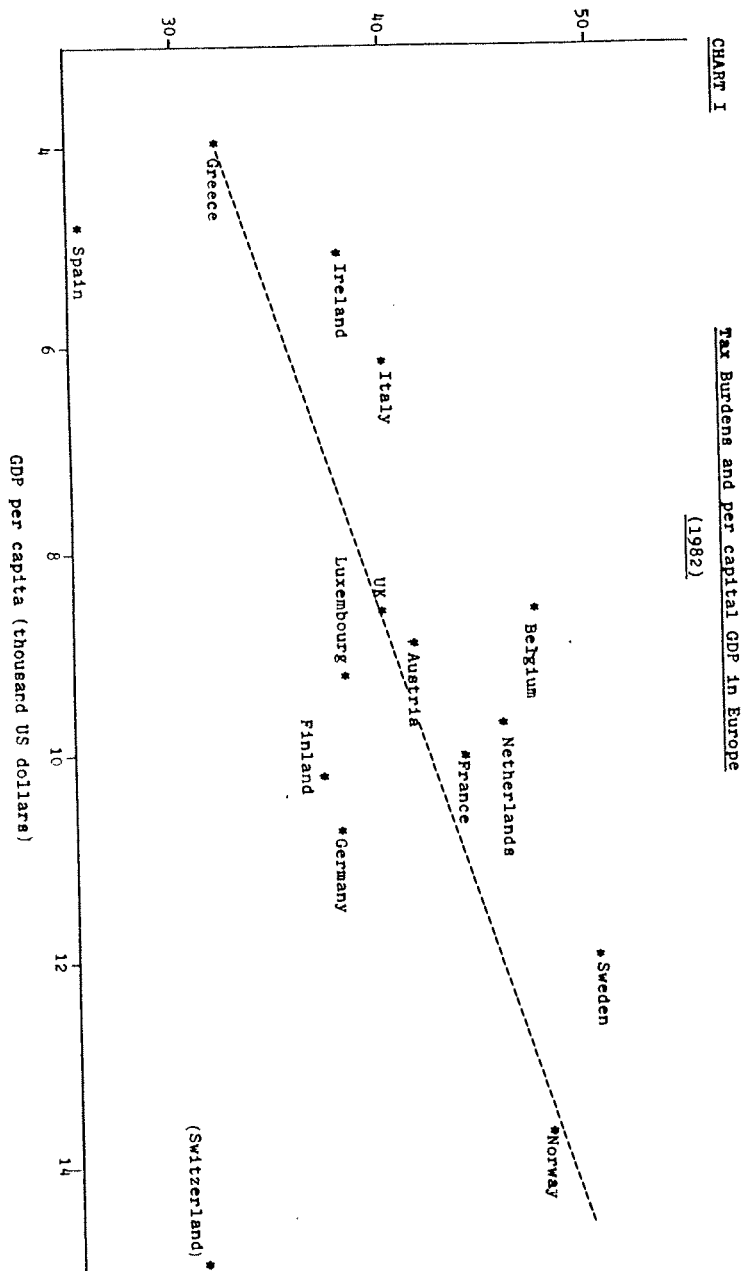
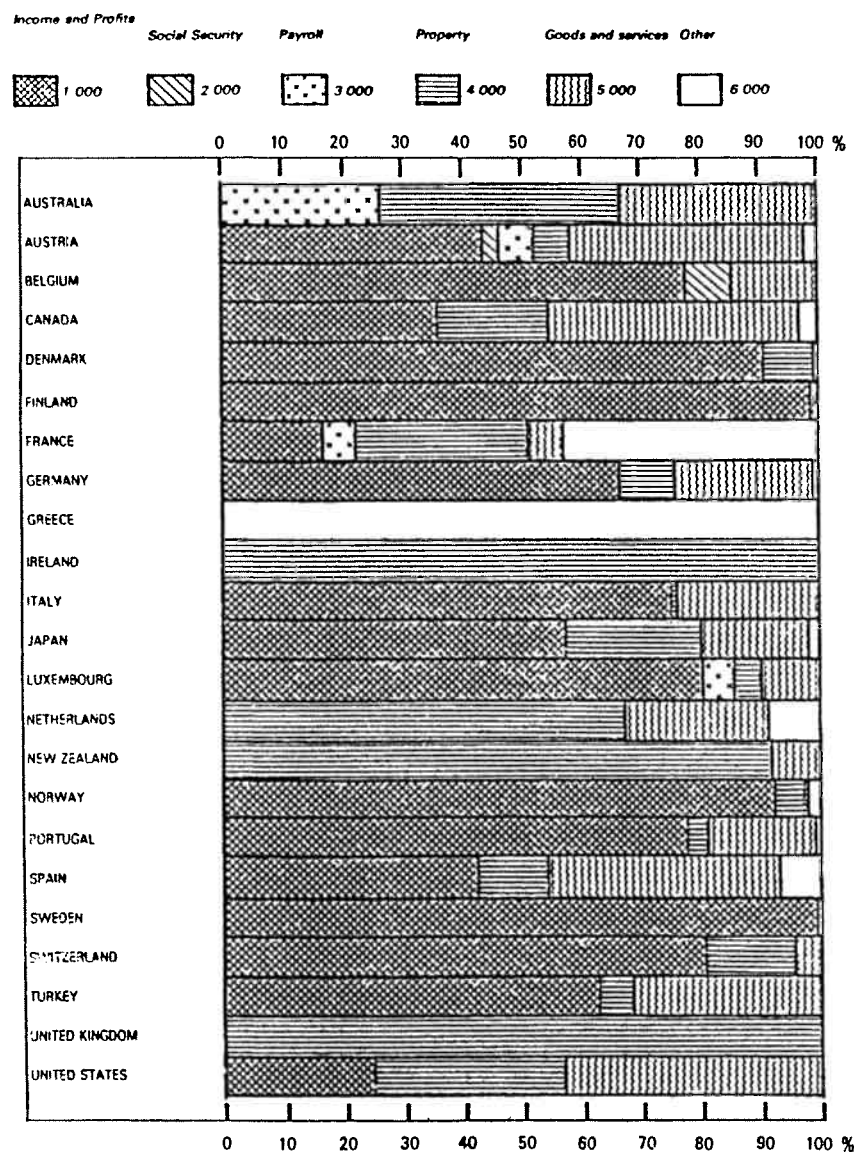


CHART III

The composition of state and local government tax receipts¹

1982



1. This refers to only those taxes which are classified as state and local government taxes and excludes transfers from central governments.

Source: Revenue Statistics of OECD member countries 1965-83

Table 1

Government Outlays and Receipts in European Countries 1981

	Government spending	Government receipts	Budget surplus (+) or deficit (-)
	as proportion of GDP		
Ireland	51.1	42.3	-8.8
Europe			
Austria	50.1	47.8	-2.3
Belgium	55.6	43.7	-11.9
Denmark	59.5	51.7	-7.8
Finland	39.2	39.7	+0.5
France	49.2	46.1	-3.1
Germany	49.3	44.7	-4.6
Greece	36.0	30.4	-5.6
Italy	51.2	39.3	-11.9
Netherlands	61.1	55.0	-6.1
Norway	48.5	52.8	+4.3
Spain	34.1	30.6	-3.5
Sweden	65.3	59.0	-6.3
Switzerland	28.9	32.8	+3.9
UK	48.0	42.5	-5.5
European average (unweighted)	48.3	44.0	-4.3
Other countries			
USA	35.3	32.7	-3.0
Japan	34.5	29.4	-5.1

Source: OECD Economic Outlook, July 1984, Tables R8 and R9.

Allocation of Functions to Local and Regional Authorities
(As at 1978)

	Belgium	Denmark	France	Germany	Ireland	Italy	Luxembourg	Netherlands	UK
Police	L			R,L					
Fire	L			L				R,L	L
Education	R,L	R,L	L	R,L	L			L	L
Higher Education	R,L			R		R,L		L	L
Health	R,L	R,L	L	R,L		R,L		L	L
Welfare Services	R,L	L	L	R,L		R,L		L	L
Housing	L		L	R,L		R,L		L	L
Planning	L	L	L	L	L	R,L		R,L	L
Refuse	L	L	L	L	L	R,L		R,L	L
Recreation	R,L	R,L	L	R,L	L	R,L		R,L	L
Roads	R,L	R,L	L	R,L	L	R,L		R,L	L
Urban transport		L	L	R,L	L	R,L		R,L	L
Ports or airports	L		R,L	L	L	L		L	L
Water	L		L	L	L	L		L	L
Electric	R,L	L		L	L	R,L	L	R,L	L
Agriculture	R,L			R,L		L		R,L	L
Tourism	R,L		L	R,L		R		L	L

Notes: R = Regional level.
L = Local level (including Department in France).

Source: Derived from Council of Europe Study Series of Local and Regional Authorities: Study No. 24, 1981.

Table 3
Revenue for Local Authorities: 1978

Figures in percentages	Belgium	Denmark	France ('76)	Germany ('76)	Ireland ('83)	Italy	Luxembourg ('76)	Netherlands	United Kingdom
Sales taxes	1.1	—	5.6	0.4	—	2.4	—	2.4	—
Income taxes	10.2	29.6	—	14.2	—	—	—	—	—
Land or property taxes	16.1	2.9	7.6	4.4	11.8	0.6	5.0	3.3	28.1
Other local taxes	1.9	0.3	27.9	15.0	—	7.1	42.2	—	—
Total local taxes	29.3	32.8	41.1	34.0	11.8	10.1	47.2	5.7	28.1
State transfers	58.1	52.6	43.4	29.3	65.4	31.3	51.3	79.2	57.0
Charges and returns for services	2.9	12.7	14.0	33.8	22.8*	54.9	1.5	5.8	13.6
Other income	9.7	1.9	1.5	2.9	—	3.7	—	9.3	1.3
Total	100	100	100	100	100	100	100	100	100

*including house loan repayments.

Source: Ireland, see Table 4. Other countries: Council of Europe, Study series on local and regional authorities Study No. 24, 1981.

Sources of Local Authority Finance
Revenue Account 1976-1984

	Gross expenditure IR£m	Total IR£m	Rates		Grants		Others	
			IR£m	%	IR£m	%	IR£m	%
1976 out turn	263	269	109	40.5	103	38.3	57	21.2
1977 "	317	318	111	34.9	138	43.4	69	21.7
1978 "	374	385	82	21.3	227	59.0	76	19.7
1979 "	458	451	91	20.2	266	59.0	94	20.8
1980 "	542	522	103	19.7	308	57.3	111	21.3
1981) estimated	674	649	101	15.5	395	60.9	153	23.6
1982) out turn	827	810	93	11.5	523	64.6	194	29.9
1983 estimate	932	932	110	11.8	610	65.5	212	22.7
1984 projection	1029	1029	126	12.3	658	63.9	245	23.8

Sources: 1976-83, *Local Authority Estimates*, successive years. The 1984 projections are those of the Department of the Environment.

Table 5

Aggregate Local Authority Expenditure: 1976-1984

A: Current Prices

	Current IR£m	%	Capital* IR£m	Total %	Local authority expenditure as a % of:	
					Total public authorities' expenditure %	GNP %
1976	263	(68.0)	124	387	15.6	8.5
1977	317	(72.2)	122	439	14.6	8.1
1978	374	(71.0)	153	527	14.6	8.4
1979	458	(72.1)	177	635	14.3	8.7
1980	542	(71.0)	226	768	13.7	8.9
1981	674	(67.8)	320	994	14.3	9.7
1982	827	(67.6)	396	1223	13.4	10.4 (prov.)
1983	932	(70.2)	395	1327	n.a.	10.0
1984 (estimate)	1029	(71.9)	402	1431	n.a.	n.a.

Note: In certain cases, the treatment of expenditure as a current or capital item differs between central government and local authorities. Only expenditure financed by repayable loans is treated as capital by local authorities.

Sources: Current and capital expenditure of local authorities as for Table 1. Total public expenditure from *National Income and Expenditure* 1981, 1982, Table A17. Gross National Product from *Economic Review and Outlook*, Summer 1984, Table 2.

B: In Cost Terms in May 1983: IR£m

	Current	% increase	Capital	% increase	Total	% increase
1976	662	—	236	—	898	—
1977	703	+6.2	264	+11.9	966	+7.6
1978	771	+9.7	315	+19.3	1087	+12.5
1979	834	+8.2	322	+2.2	1157	+6.4
1980	834	0	348	+8.1	1182	+2.2
1981	861	+3.2	412	+18.4	1272	+7.6
1982	903	+4.9	433	+5.1	1341	+5.4
1983	932	+3.2	395	-8.8	1327	-1.0

*Public Capital Programme (PCP) provision.

Source: Table 5A expenditure figures converted into cost terms by use of the conversion factor in "Purchasing Power of the Pound" derived from the Central Statistical Office.

Table 6

Current Expenditure by Programme Group
1976-82

A: Gross Expenditure: IR£m

Programme group	Out turns					Estimated out turns	
	1976	1977	1978	1979	1980	1981	1982
1. Housing	76.0	93.6	103.9	123.5	151.0	186.0	225.8
2. Roads	69.1	86.9	107.3	131.2	156.3	188.9	225.1
3. Water	32.1	40.3	47.9	57.9	72.9	87.4	108.6
4. Development	5.0	6.1	8.3	9.5	11.4	14.5	16.0
5. Environmental	20.9	25.6	31.7	41.0	51.3	65.6	80.2
6. Recreation	13.0	17.1	23.3	29.2	33.4	37.8	51.0
7. Agriculture etc*	25.8	24.1	24.9	28.8	33.0	44.8	54.4
8. Miscellaneous	21.0	23.3	26.5	36.7	32.3	59.1	65.9
Total	262.9	317.0	373.8	457.8	541.6	684.1	827.0

B: Net Expenditure: IR£m

(i.e. expenditure financial from rates and the Government grant in relief of domestic rates)

Programme group	1976	1977	1978	1979	1980	1981	1982
1.				17.3	18.0	18.6	26.3
2.				70.6	79.2	89.4	105.1
3.				37.2	42.7	50.8	62.4
4.				8.2	9.7	10.5	13.2
5.				35.8	45.0	54.8	69.8
6.				22.0	25.8	29.8	35.4
7.				19.3	23.3	25.6	30.9
8.				11.7	9.1	11.9	1.1
Total				222.1	252.8	291.4	344.2

*includes contributions to agriculture, education, health and welfare functions.
Source: Local Authority Estimates, successive years.

Table 7

Current Expenditure in Cost Terms by Programme Group 1976-82 in May 1983 IR£m

A: Gross Expenditure

Programme group	1976	1977	1978	1979	1980	1981	1982	Increase 1982 on 1976: %
1. Housing	191.4	207.5	214.2	225.0	232.3	237.5	246.5	+28.8
2. Roads	174.1	192.7	221.2	239.0	240.5	241.3	245.7	+41.1
3. Water	80.9	89.4	98.8	105.5	112.2	111.6	118.6	+46.6
4. Development	12.6	13.5	17.1	17.3	17.5	18.5	17.5	+38.9
5. Environmental	52.6	56.8	65.4	74.7	78.9	83.8	87.6	+66.5
6. Recreation	32.7	37.9	48.0	53.2	51.4	48.3	55.7	+70.3
7. Agriculture etc	65.0	53.4	51.3	52.5	50.8	57.2	59.4	-8.6
8. Miscellaneous	52.9	51.7	54.6	66.8	49.7	75.5	71.9	+35.9
Total	662.2	702.9	770.7	833.9	833.2	873.7	902.8	+36.3

B: Net Expenditure

Programme group	1979	1980	1981	1982	Increase 1982 on 1979: %
1.	31.5	27.7	23.8	28.7	-8.9
2.	128.6	121.8	114.2	114.7	-10.8
3.	67.8	65.7	64.9	68.1	+0.4
4.	14.9	14.9	13.4	14.4	-3.4
5.	65.2	69.2	70.0	76.2	+16.9
6.	40.1	39.7	38.1	38.6	-3.7
7.	35.2	35.8	32.7	33.7	-4.3
8.	21.3	14.0	15.2	1.2	-94.4
Total	404.6	388.9	372.2	375.8	-7.1

Source: As for Table 6. Converted to cost terms by use of conversion factor in "Purchasing Power of the Pound", derived from Central Statistical Office.

Table 8

Financing Sources of Gross Expenditure 1976-1982
in Cost Terms May 1983 IR£m

	1979	1980	1981	1982	Increase 1982 on 1979: %
Net expenditure	404.6	388.9	372.2	375.8	-7.1
Specific grants	258.1	273.5	306.1	315.2	+22.1
Other charges	171.2	170.8	195.4	211.8	+23.7
Gross expenditure	833.9	833.2	873.7	902.8	+8.3

Source: Net and gross expenditure from Table 7, charges from Table 4 adjusted to cost terms, and specific grants calculated as a residual. (Net expenditure is financed from rates and rate deficiency grants).

Table 9

County Council	Total rateable value £000's 1977	Population thousands (1979)	Rateable value per head £/head	Rate in £ 1977	Rates per head 1977
Carlow	238.6	38.6	6.16	8.40	51.74
Cavan	337.4	53.7	6.28	9.20	57.77
Clare	509.8	84.9	6.00	9.00	54.00
Cork	1,586.1	257.9	6.15	9.16-9.98	56.3-61.37
Donegal	474.1	121.9	3.88	12.24	47.49
Dublin	2,785.2	439.1	6.34	10.50	66.57
Galway	858.6	167.8	5.11	9.83	50.23
Kerry	526.4	120.3	4.37	11.25	49.16
Kildare	537.8	97.1	5.53	7.10	39.26
Kilkenny	467.5	69.1	6.76	7.58	51.24
Laoighis	303.4	49.9	6.08	8.30	50.46
Leitrim	159.4	27.8	5.73	9.84	56.38
Limerick	609.9	96.8	6.30	8.69	54.74
Longford	192.7	30.9	6.27	9.47	59.37
Louth	501.2	86.1	5.82	7.35	42.77
Mayo	485.6	114.0	4.25	13.00	55.25
Meath	739.6	90.7	8.15	6.55	53.38
Monaghan	338.2	50.3	6.72	7.90	53.08
Offaly	322.0	57.3	5.61	8.02	44.99
Roscommon	356.9	54.1	6.59	9.91	65.30
Sligo	306.0	54.6	5.60	8.39	46.98
Tipperary N.R.	373.0	58.4	6.38	9.07	57.86
Tipperary S.R.	503.1	75.2	6.69	8.76	58.60
Waterford	364.2	54.6	6.67	9.62	64.16
Westmeath	416.4	59.8	6.96	7.10	49.41
Wexford	527.4	96.4	5.47	8.93	48.84
Wicklow	507.5	83.9	6.04	9.47	57.17
County Borough Corporations					
Cork	763.1	138.2	5.52	9.40	51.88
Dublin	4,517.8	544.5	8.29	8.04	66.65
Limerick	315.5	60.6	5.20	10.50	54.60
Waterford	180.9	32.6	5.54	10.21	56.56

Source: Department of Environment.

NOTE: The date on the front cover of the report refers to the date the report was submitted to the Government. The dates listed here are the dates of publication.

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