

Norman Flynn¹

FINANCING OF LOCAL GOVERNMENT IN GREAT BRITAIN

Sources of Revenue

1. Introduction

The local government finance system in Britain has been in a state of reform and discussion about reform for the last ten years. The reforms in recent years have been designed to allow central government to gain more control over the expenditure of local authorities. However, until a measure which the Government is introducing this year, the local authorities have been free to raise whatever rates (a tax on property) which they feel appropriate. Until this measure the attempt to control expenditure has been made through the manipulation of grants from central to local government.

British local authorities maintain three sets of accounts. The sources of revenue into these accounts are:

1. Housing Revenue Account: the main revenue is rents on housing, supplemented by housing subsidy from central government (a very small amount and only in certain cases) and contributions from the general rate fund if the account is in deficit.
2. Trading Accounts: services which are operated as trading enterprises produce revenues in the form of charges for use e.g. markets, airports, public transport.
3. General Rate Fund: for local government as a whole, the sources of revenue for the general rate fund

¹ Doctor at Institute of Local Government Studies, University of Birmingham.

(which accounts for over 80% of all expenditure) are: government grants (44.2%); rates (34.9%); fees, charges, sales and interest receipts (20.9%).

Sources of revenue for a typical urban authority are shown in the diagram.

2. Housing Rents and Housing Subsidies

Housing rents for municipal housing are set by the local authorities, but their level is influenced by central government policy on subsidy. It is central government's policy to reduce general subsidies on housing by increasing rents so that they cover the costs of providing the service. Subsidy has been reduced in recent years:

Year	Housing Subsidy Million
1980/81	1664
1981/82	935
1982/83	591

(Source: D. McCulloch, "The New Housing Finance System" Local Government Studies, May/June 1982)

The general subsidy to all tenants is being replaced by Housing Benefit, which is paid to tenants in municipal and private rented housing who are in receipt of low incomes.

Guidelines are issued to local authorities about the level of rent increases. If these guidelines are not followed, the amount of subsidy is reduced. In Scotland the capital expenditure authorisations are reduced if rents are not increased in line with the guidelines.

If Housing Revenue Accounts are in deficit at the levels of rents and subsidies prevailing, the deficit must be financed by contributions from the general rate fund. Because of increased rents in recent years the amount of these contributions has also been falling:

Year	General Rate fund contribution to Housing Revenue Accounts £ Million
1980/81	524

Year	General Rate fund contribution to Housing Revenue Accounts £ Million
1981/82	353
1982/83	145

(Source: McCulloch)

3. Trading Services

Services which are provided in a commercial manner are expected to generate sufficient revenue to cover the cost of providing the service. In practice many services run at a loss and the accounts have to be subsidised from the general rate fund.

The services which are provided commercially have changed during the last century. Gas, electricity and water all used to be provided by local authorities but are now supplied by national or regional undertakings. Airports are still run by some local authorities, but many have been taken over by the British Airports Authority. Services which remain include:

- a. Passenger transport: local government provides bus services and in one case (Tyne and Wear) an underground railway. They may decide to operate these services at a deficit to encourage the use of public transport and thus reduce expenditure on highways and car parks.
- b. Airports: certain municipal airports (such as Birmingham) operate at a surplus while others (such as Liverpool) operate at a loss. An authority may judge that the benefits to an area of an airport justify subsidising a loss.
- c. Restaurants: many authorities own restaurants which are run in a similar way to commercial restaurants.
- d. Markets: wholesale and retail markets are run, sometimes at a profit to the authority.
- e. Theatres are operated, some with national subsidies and some in conjunction with the private sector.
- f. Cemeteries and crematoria: the charges for burials and cremations are normally set to cover the cost of providing the service.

In general, because of the transfer of certain services to other bodies, the amount of municipal trading activity is reducing.

4. Fees and charges for other services

In addition to these trading services, authorities charge fees to the users of some services. These include:

- a. Charges for inhabitants of old people's homes and children's homes. These are often payments made from social security payments to the inhabitants.
- b. Charges for education services: fees are charged for courses at Polytechnics and Further and Adult Education Institutions. Charges are also made for school meals.
- c. Some facilities are provided with a charge to the users, such as swimming pools, leisure centres, rents of buildings other than housing (such as factory units), car parking charges.
- d. Charges for work done to private property e.g. private roads, drains, the collection of commercial waste.

The levels of fees charged depend on a balance between the desire to make the facilities available to as many people as possible and the desire to raise revenue. In many cases lower charges are made to old people, children and the unemployed.

5. Licences

Various licences produce revenues, such as those for cinemas, and theatres, private employment agencies, money-lenders, gambling establishments. The levels of most of these licence charges are fixed by central government.

6. Lotteries

Since the Lotteries and Amusements Act 1976, authorities are empowered to run lotteries, the proceeds of which can be used for any purposes for which the authority is empowered to make expenditure.

7. Interest Receipts

Authorities may hold substantial cash balances and will at certain periods of the year have holdings of cash surpluses. These are invested and the interest received contributes to the general rate fund.

8. Rates

Rates are a property tax levied on the annual value of the property and payable by the occupier of that property. The annual value of a property is assessed (the "rateable value") and a charge made on that value (the "rate poundage"). The District authorities collect the rates in England and Wales, and the County authorities issue a "precept" to the districts to produce their own rate revenue.

Rates are levied on all land and buildings except: crown properties (although, in practice, the government makes a payment instead of rates for these); agricultural land and buildings; churches; buildings used by charities; parks.

The distribution of payments among different classes of rate payers for Birmingham is shown in the diagram.

The issues arising about rates in Britain are:

- a. The basis of valuation: it is argued by some that the calculation of the value based on a notional annual income is less accurate than a capital valuation.
- b. The use of property values as a basis of taxation: companies argue that rates should not be based on the valuation of assets, but the profits of the company, as other taxes are.
- c. The payment of rates by the occupiers of property in an area, rather than the users of the services e.g. in cities where the day-time population is higher than the residential population.
- d. The fact that the amount of rates levied does not rise automatically with inflation as does e.g. value added tax makes the tax very visible and therefore unpopular.

Various enquiries have suggested the replacement of rates by other taxes e.g. local income tax or sales tax. So far, no government has been willing to implement the replacement. (Sec G. Jones and J.D. Stewart "In Defence of Local Government" Allen and Unwin 1983).

9. Central Government Grants

There are three types of central government grant for revenue expenditure:

- a. Domestic rate relief grant, which is a fixed subsidy for all domestic ratepayers (this grant totalled £692 million in 1984/5).
- b. Specific and supplementary grants, which may only be spent on the services for which they are provided. These totalled £2,549 million in 1984/5 and included £1,218.8 m for police expenditure, £150 m for the urban programme for inner cities, £328 m for housing improvement grants and area improvement grants, £115 m for magistrates courts.
- c. Block grant which is used to subsidise all services and may be spent at the discretion of the local authorities. This grant, which totalled £8,631 million in 1984/5, is used to make up the difference between the amount which can be raised locally through the rates when a standard rate poundage is applied and the amount which central government believes each authority needs to spend to provide a standard level of service.

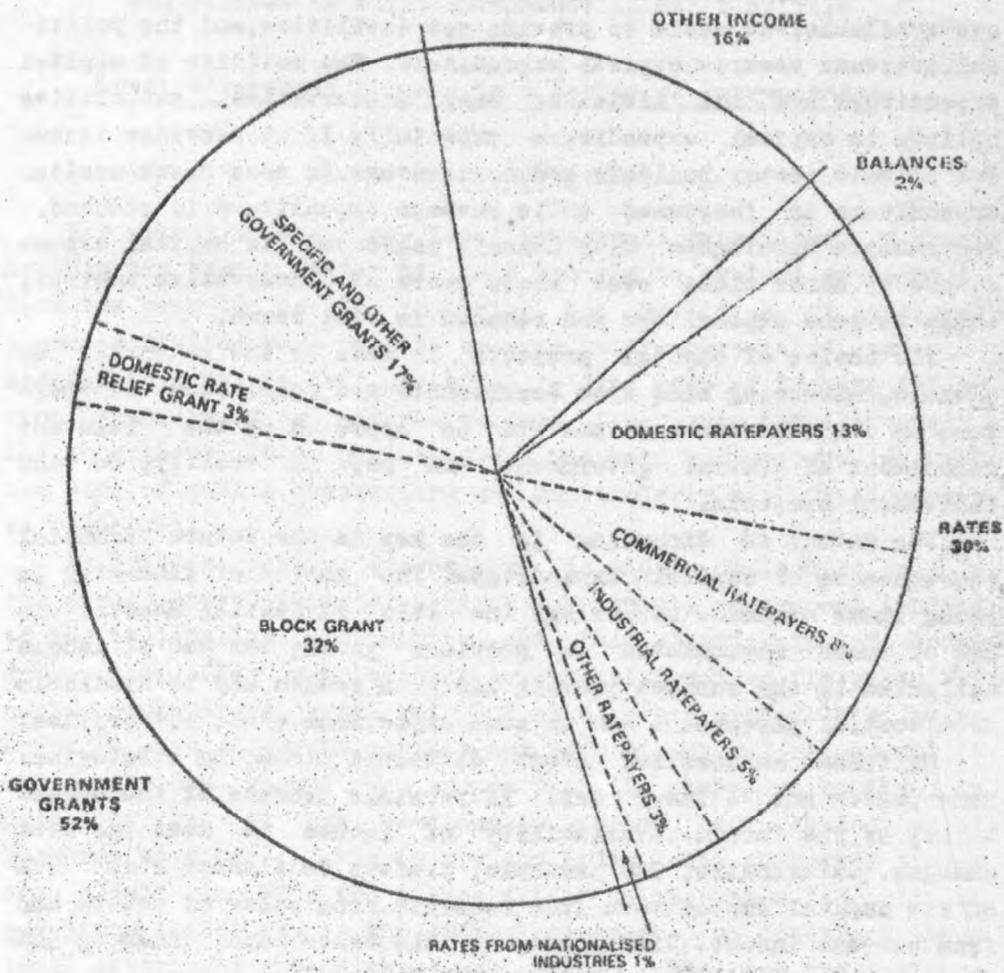
This grant has been used to persuade local authorities to reduce their expenditures to the levels desired by local authorities. Grant is withheld from authorities which exceed the targets set by central government.

10. Conclusions

The finance system of local government has arisen in a fragmentary way over many years, for example the rating system can be traced back to the Poor Relief Act of 1601. Recent years have brought attempts to change the system, mainly with the objective

Revenue Estimates

WHERE THE MONEY COMES FROM
To finance City Council gross expenditure



Note

Nationally, Government grants meet 52.8% of total local authority net expenditure before the deduction of certain specific grants. The City's percentage is 55%.

of increasing central government's power over local authorities expenditure. The latest measure, the Rates Bill, which is currently being debated will allow central government to control the rates levied by any authority which spends more than central government thinks is appropriate.

The overall level of expenditure will be based on the resources available, the needs to provide new facilities, and the political attitude towards capital expenditure. The politics of capital expenditure are not divisive: many Conservative authorities believe in capital expenditure especially if it provides income for private sector builders and contractors. In some cases capital expenditure is increased while revenue expenditure is reduced. For example Birmingham City Council increased its capital expenditure by three times over three years of Conservative control, while revenue expenditure was reduced in real terms.

The choice of capital projects is made by the authority as a whole, assessing bids from departments and committees. Expenditure on capital schemes has to be approved by the relevant department of central government and so, in reality, do the individual projects.

The method of financing is the key to the future financial consequences of capital expenditure. The choice of financing is among these methods: borrowing; the sale of capital assets; the use of funds accumulated in previous years; the use of income collected in the current year. In addition grants may be available from central government and, in some cases, from other authorities.

Different authorities adopt different financing strategies. Some prefer not to incur debt if possible because of the uncertainty of the future availability of income to meet the debt charges. Oxfordshire, for example, prefers to finance about 70% of its capital expenditure from receipts from sales of assets and from current income. Birmingham, on the other hand, finances 90% of capital expenditure from borrowing.