

## **The Political Economy of Local Tax Reform in Scotland**

### **Summary**

Revenue from council tax is insufficient to pay for the services that local authorities provide. It is, moreover, a highly regressive tax. And there are discrepancies in the valuations of newly built and older properties on which council tax is calculated. The Scottish Government took the political decision at the end of November 2014 to set up a commission on the reform of local tax.

Before that announcement, I favoured the addition of higher bands to make council tax progressive, to bring in more money and to start making valuations more consistent. Assuming that the recommendations of the Commission are accepted, it will take some time to put a new system in place. Starting with the highest value properties, using the 1991-93 valuations to identify them, I propose levying a proportion of their present value as a supplementary charge for 2015-16.

Local Tax reform will not eliminate inequality, poverty, homelessness, house-price inflation or financial misconduct. But these are all problems that Local Tax reform can alleviate.

### **Recommendations:**

1. Introduce a bill for the revaluation of properties at the beginning of the parliamentary session in September 2015.
2. Levy a supplementary charge for 2015-16 starting with the highest value properties.
3. Complete revaluation of all properties and set a new property tax, abolishing exemptions such as those for fee-paying schools and other "charities".

### **Context**

I put the debate in Scotland in the wider context of competing visions of the economy derived from the history of economic ideas and in the context of the economic history of the financial crisis. In other words I offer some understanding of why we are where we are and what is to be done. What is needed, in my view, is investment and the finance for investment. Local authorities can raise the finance needed.

Meanwhile, the project of the Conservative government in Westminster is to change the balance of the economy to reduce the size of the public sector and allow more scope for business. More immediately, they are implementing a policy of cuts to welfare benefits which impact most on women and children. Since the vision of the government in Scotland is different, the challenge is to devise elements of a distinct economic policy for Scotland within the constraints of the constitution.

### **Mixed Economies**

All national economies are mixed economies with a public sector, business sector, a community sector and a household sector. There are political differences of opinion about the desirable relative size of the public sector and the role of the state. There are

also differences of opinion about policy. The Conservative preference is for reducing the size of the public sector to allow more scope for business. An alternative vision of the economy is one in which people have shorter working hours in full-time employment with adequate income from the business or the public sector. They can then spend more time in household and community activities. This difference is about getting a balance in the economy to accord better with Scotland's politics, having a substantial public sector and a lively business sector, not too dependent on foreign capital.

Some of the political energy used to protest about Tory cuts, closures and privatisations in solidarity with protests in London, Bristol and Sheffield at some stage may be transformed into movement towards a mixed economy that accords with the politics. Many of the voluntary groups that exist are ready to take action to expand the community sector<sup>1</sup>.

Scotland's economy like all national economies is constrained or circumscribed in various ways, the policies imposed from Westminster being just one of these ways. In the longer run, raising funds for investment can be anticipated to change the structure of Scotland's economy and society to accord more with its political culture.

### **The ruling economic theory**

About 1980, economists who subscribed to the ruling theory became less tolerant of the ideas of heterodox theorists (specifically Keynesian and Classical Political Economy theorists) in universities and economics journals. And so, I view with a certain scepticism reference to established international norms<sup>2</sup>. Reagonomics reinforced by the so-called Washington Consensus 1989 or neo-liberal economics led to continuing deregulation until the financial crash of 2008. Since the crash, measures to re-regulate the financial system have been accompanied by criticism of the ruling orthodoxy, not only from students seeking to change the teaching of economics<sup>3</sup>, but also from distinguished academics. They link up with The Other Economic Summit (TOES) founded 1984 and the New Economics Foundation, 1986. But power lies elsewhere.

The financial crisis originated in the housing market. Northern Rock offered mortgages of 125% of the house value, banking on rising prices to enable the loan to be recovered on resale. Banks offered mortgages to people too poor to repay and other financial institutions invented securitisation, paper assets which they could buy and sell to spread the risk of these so-called sub-prime mortgages.

### **The distinction between an appreciating asset and a place to live**

The housing market in the UK needs regulation like the asset market that caused the financial crisis. Houses are bought and sold not just as places to live but also as assets on which, in a period of continuing rising prices, capital gains are expected. An estate agent recently sold a townhouse in Heriot Row, Edinburgh, for over £2,000,000, the sixth time the firm has sold this house in the past 20 years from an original price of £250,000. This latest sale would represent an increase of over 750%, out-performing even a peak oil investment. It is unlikely that mobility of the labour force in particular or the population in general is such that six households would want to move on average every three years just to find a suitable place to live.

Opposition to a transactions tax like the LBTT, on grounds of “inefficiency”, fails to take account of the fact that a transaction tax helps to avoid this speculation or churn. And the term “market distortion”<sup>4</sup> suggests that pre-tax market prices are undistorted by inequalities of wealth and income. That is, it accepts the inequalities of wealth as given. It is not a neutral term.

The distinction between an appreciating asset and a place to live is related in turn to the distinction between those who own and those who rent.

### **Conservative Policies on Housing and Finance**

New authorization to lift money from pension funds in the UK, without the restriction that it must be used to buy an annuity, a particular type of financial asset, has led to a rise in price of buy-to-let properties, an asset that will generate a higher stream of income in the form of rent. It has not, as jokingly suggested by the Conservative pensions’ minister, Steve Webb, led to a rise in the price of Lamborghini cars.

Tory plans to force local authorities to sell their most valuable properties and to make Housing Association properties available for purchase is in accord with their ideal of “a property-owning democracy” but will reduce the stock of housing at affordable rents and so make tenants’ lives even harder. This does not affect Scotland where sales of council houses have been stopped but I am not so sure about Housing Associations.

### **Inequalities**

Land ownership is more unequal in Scotland than in any other country in Europe. Generally, inequality of wealth is greater than inequality of income. And wealth is under-taxed. There is no such thing as a bad tax or a good tax far less an ideal tax. We should not look at any tax in isolation, but rather the whole array of taxes. I favour a good-enough tax within that array. It should be simple, say 1% of the present value of the property, and have sufficient flexibility to accommodate changing circumstances.

In the housing market tenants, especially in the privately rented sector, suffer. If local tax reform reduces house price inflation, it will somewhat diminish the capital gains of owners and thus the relative disadvantage of tenants. Other inequalities affect women and men differently. Inequality of access to credit is greater than inequality of wealth or income. Women still have less access to credit because of lower wages though the normal practice of financial institutions to demand a male guarantor for a mortgage became illegal in the 1970s. But their situation as cohabiters may still be more precarious than that of men. Since May 2015 the Marriage Tax Allowance used to reduce a husband’s tax liability may allow more money to go through his bank or building society account and so ultimately reduce her access to credit. On the other hand, between divorcing couples a mother with children usually gets the marital home. In this case we don’t rely on the market; we rely on the courts in the state sector. Homelessness among women is primarily the result of domestic violence and the refuges that offer them sanctuary are reliant on public money.

Analysis by the Fawcett Society, Engender, the Resolution Foundation and the Women's Budget Group supported by the Joseph Rowntree Foundation, show that the main impact of the welfare cuts implemented from Westminster is on women and children. The reasons for the disproportionate effect are well-documented in these studies, in particular by Engender's *A Widening Gap: Women and Welfare Reform*, 2015. Research undertaken by the Whitehall Department of Work and Pensions, by contrast, has so far not considered the impact on children, future citizens of the country.

### **Property Tax**

The advantages of property tax as a local government tax are that property is visible, it is not a form of wealth that can be hidden, its location is clear and ownership is registered. The sad story of the elderly widow with a low income living on her own in a big house is used in the case against property tax. This may rather be a matter of middle-aged offspring wanting to safeguard their inheritance. There are remedies such as deferral of payment until the property is sold. If we look at both sides of the public accounts, however, an alternative more uplifting tale can be told of solidarity (among women) in which those occupying the most valuable properties support the women and children living in poverty who use services that councils threaten to cut. The problem of so-called income-poor-asset-rich householders can be resolved by councils allowing postponement, by giving planning permission and building small, easy-to-manage houses.

### **The Freeze**

COSLA, the Convention of Scottish Local Authorities, has been calling for an end to the council tax freeze on the grounds that it is undemocratic, takes power from local communities, reduces the accountability of local government and explains in part low turnout at council elections. Relaxing the freeze, however, will not make a regressive tax progressive. If the rate is allowed to rise, people in properties valued at half a million, £1 million or £2 million will pay more, but they will be paying just the same as those living in properties valued at £212,000.

Local democracy, decision-making and provision are important values though they can be at odds with common standards and universal provision and may give rise to so-called postcode lottery. On the other hand, the desire for central government control, sometimes dressed in the language of efficiency, has affected all the main parties in the UK, including the SNP as, for example, in the case of Police Scotland. The tensions between these opposing principles or tendencies must be negotiated. They can't be resolved.

Within the SNP it is recognised that the freeze, though "popular", is not progressive. In 2015-16 it can be retained initially at least for bands A – G while a supplement is charged on higher valued properties. There are 13,000 Band H properties that were valued above £212,000 in 1991-93 and are now worth anything from £600,000 upwards. The supplementary charge would bring in funds in the present financial year 2015-16, continuing into 2016-17. This would begin to make up for underpayment by the better-off over the years. The additional revenue would be

redistributed among local authorities by the Scottish Government to offset planned cuts where need is greatest.

In this financial year 2015-16, cuts to services are planned in Scotland's 32 local authorities. Douglas Sinclair, chair of the Accounts Commission, the local government spending watchdog, reports a real terms cut of 8.5% in funding over the last 3 years. He says he expects next year's financial settlement to be worse! As indicated above, the Holyrood government intends to fund the freeze.

This will prolong the dependence of local authorities on the national government while the freeze still applying to lower valued properties is funded by Holyrood. But the extra revenue from higher valued properties will release more of the reduced block grant for other purposes. In the first instance, we could get the best of both worlds.

It may be possible to finish revaluing all property in time for the fiscal year 2016-17 or 2017-18, at the latest. Until new local tax arrangements are in place, step-by-step implementation starting with the most valuable properties to bring in funds now, could prevent further cuts, restore services and finance mitigating action against sanctions imposed from Westminster. After the Commission on Local Tax Reform reports in the autumn, we expect that funds will accumulate in the public purse. There may be enough in the public purse to allow some anti-austerity policies as well.

### **The hurdle of revaluation**

It is difficult to think of a reasonable argument against revaluation and in favour of retaining the 1991-1993 valuations of residential property. The prospect of revaluation has proved a hurdle in the past. Those whose house valuations are increased are more vocal in their opposition than those whose tax liability may decrease. And there is the whole fraught history of the Poll Tax. But the SNP government can afford to be bold. From a position of strength, it can be generous-spirited in nurturing tolerance for different views and political affiliations to build an atmosphere of trust in public life between itself and local authorities. A bill to begin revaluation of residential properties should be introduced at the start of the parliamentary session in September 2015.

Revaluation of the total housing stock, which has not been carried out for over twenty years, can be completed in an orderly manner for a more thorough reform to bring in more funds. We have had close on two decades of house-price inflation (there have been a few years of price falls) but it has not been evenly spread because the structure of the economy has changed. Oil wealth has accumulated in Aberdeen. Edinburgh has become a financial centre and seat of government. The last valuation was done over twenty years ago in 1993. The longer the base of 1991-93 is retained the more skewed the values become. The criticism that Scottish governments have not used powers they already have can at last be answered.

### **Limitations of Tests<sup>5</sup>**

Since the poor outnumber the rich, comparing the percentage of taxpayers who would gain from a tax change with the percentage that would lose gives a rough-and-ready

indication of a move in a progressive direction. But there are two sides to the public accounts: an expenditure side and a revenue side and we need to consider both. It is impossible to weigh up the cost of an extra tax payment against the experience of people who are suffering changes to their lives because of inadequate public revenue. These range from anxiety about the prospect of job loss, through despair over having lost the job, general pointlessness of filling in multiple job application forms in areas of high unemployment, weariness of job-seeking, humiliation over benefit sanctions, tension of living in a household with inadequate income, damage to children's health from relying on food banks to the indignity of living in towns without public toilets, as in pre-Victorian times, without the conditions for a civilised life. This insecurity cannot be measured against the cost of extra tax payment. There is no common yardstick for these incommensurables.

### **Local authority accounts**

Although the net position is one of debt, local authorities that have reserves could use them now to be replenished later in the expectation that funds will flow in from new revenue. Scottish councils have been borrowing, apparently with civil servants' encouragement, to offset cuts in revenue and capital funding. In total, this amounts to £15 billion or £6166 per household compared with £3100 per home in England and £2825 in Wales. The higher debt per household in Scotland may be due to higher expenditure, the lower debt per household in Wales owes something to the fact that revaluation carried out in 2003 and a modest reform of council tax have led to an increased council tax take.

### **Revenue, investment and the capital account**

Local government with a reliable flow of revenue has the power to borrow. The Scottish government, by contrast, has been allocated a fixed sum for capital expenditure (investment).

It is critical to know the form of local authority debt because rates of interest vary a lot depending on the source of the loans. Is the debt in the form of bank overdrafts? Is it owed to the UK treasury? Is it in the form of municipal or local government bonds? Neo-liberalism spawned the Private Finance Initiative (1992) and, in the same climate of opinion, the PPP (1997) or non-profit distributing contracts to finance schools, hospitals and bridges without the loan appearing as part of the public debt. The Chartered Institute for Public Finance and Accountancy (CIPFA) and Unison are exploring ways of renegotiating these contracts, as has been done by Northumbria, while the rate of interest on public borrowing is low. The exorbitant costs of Private Finance Initiative, the PPP and non-profit distributing contracts will otherwise peak around 2026-27. The Accounts Commission has called for improvement in the presentation of accounts to allow more effective scrutiny.

In general borrowing for current expenditure, although sometimes necessary as a temporary measure, is not advisable. Borrowing for capital expenditure is essential. Municipal bonds can be offered for sale on the London Stock Exchange or on a Scottish Stock Exchange. This was merged with the London Stock Exchange in 1973. The time may have come for a revival of local stock exchanges since some of the gloss has come off electronic trading with "spoofing" causing collapse in share prices in different time zones.

The Chancellor of the Exchequer does not take failure to meet his target for deficit reduction too seriously. In my view, this is because the prime aim of current policies is rather to reduce the size of the public sector. Talk of the deficit is rather an exercise in political persuasion using terms that the Conservative party thinks most people will understand. In 2010, most understood that in failing to control the banks the UK Labour government had allowed the financial crisis to occur. They were not alone. It was a global financial crisis affecting the United States, Ireland, Scotland (RBS), Iceland, Greece and others. In the climate of neo-liberalism, there had been a policy misjudgement. After the crisis, the Labour Government policy was broadly correct. The deficit was to be reduced by a mix of tax increases and spending cuts. In the years since 2010, however, this understanding has been undermined by a story of profligacy in the public sector.

### **The Public Purse**

Given that the Smith Commission has not come up with satisfactory means of raising finance at a national level in Scotland, it is particularly important that revenue accrues to the public purse from the new local tax. This could begin in the financial year 2015-16, as already mentioned, bringing in funds now to deal with those problems arising from cuts that can only be remedied with cash.

Doubling council tax on second homes, as proposed by Leanne Wood in the 2015 BBC hustings debate would bring in funds. More importantly ending exemptions for fee-paying schools and other “charities” and ...

According to the Westminster government, there will be no fiscal autonomy before 2020. This gives time to devise a comprehensive tax system in which local tax will be the first substantial component to replenish the public purse, a step towards reconstituting the public finances in Scotland to pursue a distinct economic policy within the confines of the UK state.

I have referred to a couple of years when the reform of local tax is being implemented. There remains the question, for the longer term, of how much of what they spend the 32 local authorities collectively should raise. Should Holyrood skim off some from wealthier areas to redistribute to poorer areas on the basis of need? When the new local tax is up and running throughout, we can test COSLA’s expectation that the higher the percentage of expenditure paid locally the more engaged populations will be and the more they will hold local authorities to account. In the longer run, it should be possible to devise a system of checks and balances with scope for local authorities to vary the rate.

### **Tax, Franchise and Citizenship**

The fact that the valuation officer is still the Electoral Registration Officer is a relic of a franchise confined to owners of property. The general principle is accepted now that everyone, from global corporate giant Amazon (which until May 2015 avoided recording UK sales on which corporation tax should have been paid) to children shelling out VAT on sweets, should pay for the public provision of services from which all benefit. The incendiary poll tax followed this principle. Citizenship became an issue when people who didn’t pay the poll tax and dropped off the electoral roll,

registered for the right to vote in the Independence referendum. The stand-off between councils with their obligation to collect arrears and the Holyrood Government who wanted forgiveness for old debts ended when the Scottish Government agreed to pay local authorities for poll tax (Community Charge) debt in March 2015.

Although credit card debt has declined from the levels it reached at the time of the financial crisis, council tax debt and debt incurred through the courts has increased. Private debt is a problem for individuals unless they can easily meet repayments. But reducing public debt, the national debt, as the Chancellor of the Exchequer intends, deprives public investment of the lowest cost finance. In addition, it reduces the supply of the safest financial assets available to pension funds and other savers.

Barbara MacLennan  
June 2015.

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<sup>1</sup> Community Empowerment Bill with cross-party support passed through Scottish parliament, June 2015. There is also a Community Ownership Support Service (Coss) N170615

<sup>2</sup> Memorandum distributed to the Commission.

<sup>3</sup> For example Glasgow University Real World Economics Society

<https://www.facebook.com/GURWES>

<http://www.worldeconomicsassociation.org/newsletterarticles/gurwes/>

<sup>4</sup> Paper presented to the Commission by Professor J. Gallagher.

<sup>5</sup> Paper presented to the Commission by Professor J. Gallagher.