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Featured graphic: Local taxation and spending as a share of GDP in large Western European countries

According to the OECD, local authorities in four of the five largest Western European countries now levy taxes that exceed 3% of their country's GDP. Municipalities in each country use these taxes to fund around half of their spending: the balance is largely made up of central grants, many of which are earmarked for spending on services such as schools or the police. This has been the case in France, Spain and post-unification Germany since data became available for each country, and has also characterised the situation in Italy since Italian local authorities were granted greater fiscal powers in the late 1990s. As such, local government in each of these countries enjoys a reasonable degree of decision-making autonomy from the centre in terms of fiscal and spending policies.

By comparison, the United Kingdom is a clear outlier: local taxation revenue equalled only 1.7% of the UK's GDP in 2012 (the latest year for which data are available), whereas over 13% of GDP was spent on local services. Despite changes in party-political control at the national level this gap has remained largely stable for over two decades, as the UK Government has continued to exert significant influence over local taxation and public spending.

However, it was not ever thus. Upon the introduction of the flat-rate domestic Community Charge (Poll Tax) in 1991, ministers increased the size of central grants significantly in an attempt to soften its impact on citizens. The accompanying legislation also removed local government's power to determine business rates: central government ministers now set a single level that applies nationally. These reforms resulted in a sharp drop in revenue from local taxes, from which municipalities have never recovered – even though their levels of spending have remained fairly stable as a percentage of GDP. The Poll Tax was hugely unpopular (and in 1993 it was replaced with a Council Tax based on the value of domestic property) but its legacy remains. Indeed, it gave local government finance a toxic political profile nationally, which lingers more than two decades later. Fearful of the public's reaction, the government has never authorised a revaluation of property in England (with the result that residents still receive bills based on the value of their home in 1991) and also "capped" numerous councils that proposed raising it by what ministers believed was an "excessive" amount. Although a 2011 reform removed capping, large increases now need to be authorised in a local referendum – an outcome so unlikely to happen that it represents a cap in all but name. As a result, the income that municipalities can generate from Council Tax – the only significant source of revenue over which they have any control – is also largely determined by government ministers. The result is a severe example of vertical fiscal imbalance (McLean 2005) that has major implications for local democracy and economic development.

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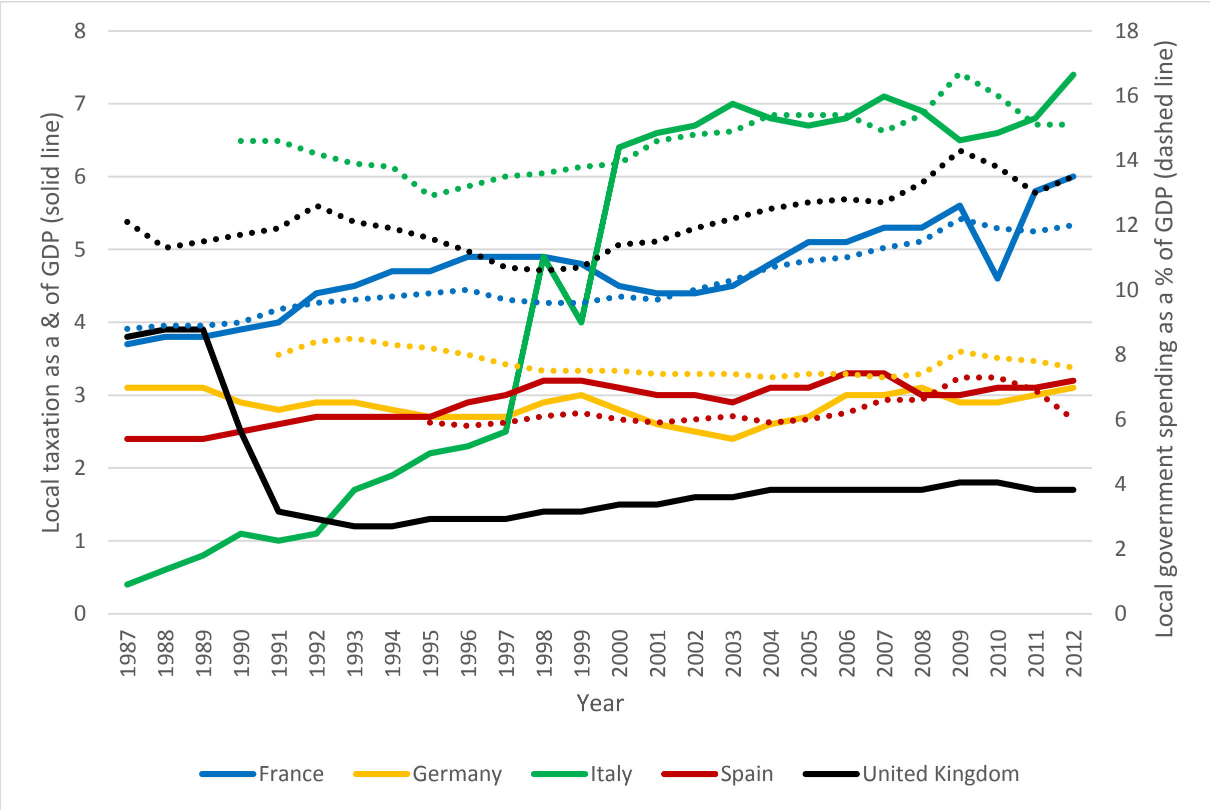

Figure 1: Revenue from taxes levied by local government as a percentage of GDP (Source: OECD)[1]

[1] Spending data for Italy, Germany and Spain are only available from 1990, 1991 and 1995 respectively.