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Municipal Finance

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MUNICIPAL FINANCE.

ALTHOUGH the additional burdens thrown upon the English taxpayer during the last few years may not have outstripped the increase of his wealth, they have been out of all proportion to the benefits actually derived. Secondly, the expenditure, though not greater than his needs, fails lamentably to meet those needs. Thirdly, even supposing that the growing revenue had not been frittered away in the endowment of small classes and additions to unproductive or inefficient services, there would still remain in the minds of reformers a residuum of just discontent with the present incidence of our local taxation. Fortunately our reformers, the *rari nantes*, may encourage themselves by observing the gradual diffusion in the public mind also of a vague dissatisfaction that growing needs are not met by growing revenues, and that the revenues themselves, improperly expended, are also improperly derived. No better psychological evidence could be found than the huge crop of resolutions passed by urban authorities in different parts of the kingdom during the last two or three years in connection with the subject of the rating of ground values, or—to take another branch of municipal finance—the marked increase in the attempts made by municipalities to consolidate the areas and to acquire the collection of rates.¹

Although it has justly been observed that no human institution is capable of perfection, yet it is equally true that a school of English writers and statesmen, often predominant, has made a mental reservation in favour of all English institutions, holding them with Lord Coke to be such that “the wisdom of all the wise men in the world, if they had all met together at one time, could not have equalled.” Nevertheless, to borrow the words of an exquisite critic, the said institutions have been mending ever since by a very great number of the said wise men; and the history of

¹ In this connection should be noted, not only the private bill legislation of towns like St. Helens and Bradford, but also sections 33, 34 of the Parish Councils Act, 1894, and sections 10, 11 of the London Government Act, 1899.

British legislation affords some hope that the small local imperfections which we are about to produce may be patched up in the old illogical insular and haphazard fashion. For theoretical purposes the problem arising from these imperfections falls naturally under two great heads: the sources of local revenues and the procedure by which those revenues are collected. A third, however, obtrudes itself in the vexed question: "What are the proper purposes and limits of local expenditure?"

On the present occasion we shall confine our attention to the first head. Its importance is due to causes neither complex nor obscure. If people had remained content in the nineteenth century with the roads and drains of the eighteenth; if a few tottering veterans still served "to keep the peace"; if a stream, a woman, and a pail still constituted a water supply; if the sunset still brought darkness to the street and bedtime to the household, there would be no disturbing talk about the incidence of local taxation. But now every ratepayer in every town expects to have his street well-lighted and paved. If he is not a Londoner he expects those whom he elects to manage his municipal affairs to supply his home with a plentiful and perpetual current of gas and water at a low price. A proper system of drainage is a necessity; so is a town hall, so too are parks, trams, bands; libraries, technical schools, museums, wash-houses and art galleries are luxuries for which there is some demand. But all these things involve rates; and when the demand note swollen by such items of expenditure finds its way to the shop-keeper already harassed by the poor rate and the income tax, to say nothing of other less sensible extortions, he feels the pinch and cries out with pain. He is satisfied with the cake, and is ready that it should be larger; but he fancies that there are others who eat more and pay less. Perhaps he is right. Let us glance at the English law of rating. Of the two great principles of taxation, the principle of ability and the principle of benefit, it may be laid down as an almost self-evident maxim that while both are applicable to local as well as to imperial taxation, they are applicable in different degrees according to the difference of the subject matter. For imperial purposes ability, for local purposes benefit, should be the main criterion. So much will be admitted. The present Government, for example, has added say £10,000,000 annually to the imperial expenditure, but it would be quite impossible to apportion this according to benefit.

Municipal expenditure falls into a very different category.

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The maintenance of good water supply, roads, drains, parks and the like by a local authority confers no doubt some benefit upon the whole country; but an overwhelming proportion of that benefit is absorbed temporarily by the occupiers, permanently by the owners, of property situated in the district. Unfortunately, the rating law of England is now, practically speaking, based upon the poor rate. Rates are imposed upon visible immovable property within a given area. The assessment is upon the occupier. But his occupation must be beneficial; and the criterion is not real ability, but visible ability. The doctrine of the hypothetical tenant is very strictly applied, so much so that the same hereditament will pay the same rate whether it is occupied by a struggling farmer or a retired millionaire. Mr. Cannan notices that this characteristic feature—which causes so much astonishment to our continental critics—does in fact bring the principle of ability into contact with the principle of benefit. The compromise, slowly and clumsily evolved by justices of the peace, Judges and Parliaments, has, even to-day, one great practical merit. It avoids a local inquisition. In the spacious times of Elizabeth, when there were no factories and few towns, when the well-to-do lived on their estates, and in a splendour proportioned to their rentals, visible ability approximated very closely to real ability; house-holding was an excellent basis for a rate which, like the poor rate, is a national rather than a local concern. But the change in the habits of the rich, the growth of factories, the development of railways, the practical disappearance of the small freeholder, have revolutionised the rating question. So long as the wealthy classes are entirely composed of landed proprietors, and so long as your owners and occupiers are very largely identical, the principles of ability and benefit can be satisfied, if not logically and completely, at least easily and simultaneously, by a rate framed after the poor rate; and it matters little whether it be applied to a national purpose such as the relief of the poor, or to a local purpose such as the provision of a drainage system. In either case your Elizabethan ratepayer is the proper person to pay rates. There he is able, here he benefits. But the present century shows a wide and widening divergence between the results which are to be obtained by applying the two principles. The distinct criteria of ability and benefit can no longer be harmonised in practice; and the situation has been made tolerable, or rather the necessary and inevitable reforms have been postponed, only because palliatives have been applied in a

variety of statutes.¹ For, though the cost of making up a road or laying a sewer may be rightly apportioned, the heavy annual expenditure upon maintenance and repairs must always fall upon the General District Rate, which under the present law is imposed upon occupiers only. An imaginary case will serve to exhibit the monstrous absurdity of the system. Suppose that a local authority declined, and could not be compelled, to maintain its drains and its roads, then obviously every one who could do so would remove from the district, and the rental would suffer a severe shrinkage. Probably there would be a short fit of keen economic bargaining, which would be concluded by a compact between landlords and tenants to halve the costs of maintenance; though of course the actual proportion would depend upon the prosperity of the town and other local considerations.

In the second chapter of his fifth book, Adam Smith treats this subject with a force and earnestness that contrast remarkably with the timid tinkering spirit of most later writers. He deals with inhabited house duty,² the taxation or rating of agricultural rents and the taxation or rating of ground rents, and regards the three with favourable eyes in an ascending order of merit: in the first he sees a natural graduation of an unobjectionable kind. But ground rents and the ordinary rent of land are still more deserving of the attention of the Chancellor of the Exchequer, because, says Smith, they are "a species of revenue which the owner enjoys without any care or attention of his own; though a part of the revenue should be taken from him in order to defray the expenses of the State, no discouragement will thereby be given to any sort of industry." And he proceeds:

"Ground rents seem in this respect a more proper subject of peculiar taxation than even the ordinary rent of land. The ordinary rent of land is, in many cases, owing partly at least to the attention and good management of the landlord. A very heavy tax might discourage too much this attention and good management. Ground rents, so far as they exceed the ordinary rent of land, are altogether owing to the good government of the sovereign, which, by protecting the industry either of the whole

¹ More especially by the device of apportionment, which enables a local authority to apportion expenses incurred in the *construction* of certain works among the adjoining "owners" or lessors (not necessarily the owners of the ground. See Public Health Act, 1875, sect. 4). But the permanent benefit or "melioration," to use Pèpys' word—accrues to the owners of the ground values who do not necessarily, or as a rule, contribute to the preliminary expenditure, much less to the cost of maintenance.

² Mr. Jeeves, now the Town Clerk of Leeds, has suggested that this tax should be handed over to local authorities.

people, or of the inhabitants of some particular place, enables them to pay so much more than its real value for the ground which they build their houses upon, or to make to its owner so much more than compensation for the loss which he might sustain by this use of it. Nothing can be more reasonable than that a fund which owes its existence to the good government of the State should be taxed peculiarly, or should contribute something more than the greater part of other funds towards the support of that government."

Upon this masterly argument two remarks may be offered. The first is that our landed aristocracy took the opportunity shortly after the publication of the *Wealth of Nations* to impose a tax upon the occupiers of inhabited houses; but that never in the direst straits of the Napoleonic wars did they allow themselves to be driven to resort to the third-named source of revenue. The second remark is, that if the reasons advanced by Adam Smith made a strong case for the imposition of a ground tax in 1776, they make an overwhelming one for the imposition of a ground rate in 1899. For if in that year a considerable proportion of national expenditure went indirectly to maintain or enhance ground values, a much larger proportion of local expenditure now produce directly the same effect.

One favourite argument often brought forward by the modern opponents of a rate upon ground values is that it would make no difference, because the owner of the ground would always be able to throw it upon the lessee. If this were true the resistance would not be formidable. But we prefer to accept Professor Edgeworth's broad proposition that this tax tends to stick where it falls.¹ Adam Smith's opinion is also relevant: "A tax upon ground rents would not raise the rents of houses. It would fall upon the owner of the ground rent, who acts always as a monopolist, and exacts the greatest rent which can be got for the use of the ground As the wealth of competitors would in no respect be increased by a tax upon ground rents, they would probably not be disposed to pay more for the use of the ground."

Smith adds, rather peremptorily, that unoccupied houses ought not to be rated. But this is by no means clear. For if you rate on the English principle (expressly endorsed by Smith) your criterion is the rent at which they would let to the hypothetical tenant. But there are many stupid, obstinate landlords who over-estimate the value of their houses and keep them unlet for years. This is unprofitable for the landlord and prejudicial to the community.

¹ ECONOMIC JOURNAL, 1897, "Theory of Pure Taxation. I."

There are plenty of local Acts under which owners must pay rates on half the annual value of vacant houses; and thus a gentle financial pressure is applied to the short-sighted owner which is often good for him and always for the community. But Smith's minor canon, whether right or wrong, did not apply to the ground rate of an unoccupied house or of building land held against a market; and there is no doubt that he would have taken the side of Mr. Orford Smith against Sir Harry Poland in a recent controversy which may be found in one of the volumes of evidence given before the Royal Commission now sitting and incubating interim reports on Local Taxation. We may first consider Sir Harry Poland's abstract proposition:

"The principle is this. It [building land] is not land which is fit to be made a profit of by being let for the ordinary purposes of simple land; it is land of which at present no profitable use can be made, and which is waiting for the time to come when profitable use can be made of it by letting it out on a building contract."

Therefore, says Sir Harry, building land ought not to be rated. But it would seem that even if future legislation is to be decided by past precedents, this distinguished pleader is battling for a precedent which is itself little better than an anomaly. For take the analogous case of agricultural land. "It is quite clear," said Lord Campbell in the case of *Regina v. Foyle*, "that if a man who is in possession of the surface of the land, which, in the ordinary use of it, might be made productive, chooses only to grow thistles upon it for the use of the donkeys in the parish, he is nevertheless rateable in respect of the profit which it might reasonably be supposed he might make of it." Our ancestors saw the policy of taxing those who allowed agricultural land to lie waste. Why not apply their wisdom to urban conditions? The same witness was asked by one of the members of the Commission the following question:

"Supposing it to be proved to the rating authority that a man had some land close to a town, and we will say £800 had been offered to him for it, but that man persisted in standing out for £1,000 an acre; would you still say that that was unrateable land, with the knowledge that it was land for which the man had been offered £800 an acre?"

Answer: "I think it must be a question of degree. If he really believed it was worth £1,000 an acre, he had a perfect right to stand out for it."

No one disputes the monopolist's right to "stand out" to any extent. But surely the monopolist has the less reason to complain of a law which would rate him on the basis of a lower value

than that which he believed it to be worth. He might stand out for many years before his £1,000 would be rated away to £800. But the witness melted a little in the hands of Mr. Orford Smith, who put another case :

"Suppose you find, in a town, land fronting a street left a mere waste, while on either side of it and opposite to it you find land sold or let by the foot, or the yard, would there be any difficulty in saying that that was building land?"

Answer: "I think in that particular case you could say it was building land."

Question: "It must be a question of degree?"

Answer: "Certainly: of course, there may be difficulties in dealing with the property, and there may be some reason why it has not been let; for instance, the owner may say, 'I think, in all probability, if I hold out longer I shall get a very much better price than that which has now been offered to me.'"

Question: "That is the case, no doubt; the question, to my mind, is whether it should not be rateable. Of course, the saleable value of adjoining land in such a case as that, or the ground rent at which the land was let, would be a good guide to the value?"

Answer: "Yes, a very good guide."

Question: "Although it might not be fair to rate a man at the full amount, he might fairly be rated for a considerable amount, having some regard to the value of the land—not by law now, but, I mean, it would be a possible alteration of the law?"

Answer: "He might possibly in that case, but you must not extend that principle too far. Take Holland Park, Kensington; that would be of enormous value, of course, if it were to be built upon."

This little dialogue has been disinterred because it furnishes a concise illustration of the rhetorical method of overcoming the best equipped resistance to a great reform. A large part of the product of the ground rate should be applied to the extinction of the more noxious forms of Imperial doles; as well as to the reduction of the burden upon the occupier. In this respect, however, a ground rate is to be viewed, not as a substitute, but as an addition. Indeed the occupier's rate is one of the most potent checks on municipal extravagance and corruption, as the United States, which have it not, know to their cost. Every well to-do working man ought to feel directly through the rates the rise and fall of municipal expenditure, just as he ought to feel directly through the income tax the rise and fall of national expenditure. These are shadowy ideals difficult to realise; a patriotic statesman will guard jealously whatever substance they may be possessed of.

One more important topic that remains to be dealt with is suggested by the sentence already quoted from Adam Smith, in

which he speaks of the owner of a ground rent acting always as a monopolist.

So formulated, the proposition is too wide to be of much value. It might lead to a practical syllogism of this kind:—

The supply of land is limited ;

Therefore land is a natural monopoly ;

Therefore land ought to be nationalised.

But this is only a practical syllogism of the Hegelian school of philosophers-turned-politicians. These gentlemen generally regard all distinctions as trifling, because they are only distinctions of degree. The present writer is a disciple of the commonplace. He accepts the vulgar fact that two competing sets of tram lines cannot well run along one street. Accordingly he would call tramways a natural monopoly, and therefore a service in which strict public control or public ownership is eminently desirable. He maintains that such a classification only applies to land in very exceptional places and circumstances.

Even building land in the centre of a large town does not come within the definition of a *natural* monopoly. In Leeds, for example, which is parcelled out into comparatively small freeholds, you have the competition of sellers to set off against the competition of buyers ; but there may very well be under our present laws an *artificial* monopoly which will have an extraordinary effect upon prices. Fifteen miles from Leeds there is a town of a quarter the size which suffers from an artificial monopoly, and where, in consequence, house rents are higher, not only relatively, but absolutely. These artificial land monopolies should not be municipalised or nationalised, either by way of purchase or confiscation ; they should be financially discouraged. And such financial discouragement can easily be administered by a graduation of the ground rate. In that way the difference between monopolistic and competitive rents will be returned automatically to the community.

But to return from a digression which was only undertaken to show that the public *ownership* of land is not to be regarded as a fruitful or desirable source of public revenue. There are besides several remunerative undertakings, such as gas, water, tramways, which approximate closely to the abstract economic conception of a natural local monopoly—*i.e.*, of a service which, under normal free-trade conditions, tends to fall into single ownership ; and here the object of local finance should be to secure for the community as a whole the fullest possible share of the profits. When as in the case of water it is

for the public benefit that the use should be universal, it is desirable that the commodity should be sold at cost price. But this consideration does not apply to gas and tramways; and here the arguments put forward in Mr. Cannan's recent article¹ apply with full force. Why should the vigorous pedestrian or cyclist, or the pale-faced owner of a season ticket on an underground railway, suffer for the tramcar passenger? A reasonable profit on undertakings of this character is a perfectly legitimate form of local taxation.

There remains one other form of monopoly which demands peculiar attention from the economist. It is an accepted principle that a Government ought not to confer a valuable franchise upon an individual, except for an adequate consideration. Patents and copyrights are the stimulus as well as the reward of invention. They confer a strictly limited monopoly. They are the exceptions which prove the principle. But what words can adequately describe the folly and enormity of the laws by which there are given annually throughout this kingdom, to individuals arbitrarily chosen, by authorities arbitrarily appointed, thousands of lucrative franchises to which the donees have no claim, and for which they make a nominal payment only? If a town council were to hand over the franchise of its streets for nothing to a tramway company, its action would be regarded as a qualification for the lunatic asylum; and yet in every town and county franchises certainly far more valuable in the aggregate are presented every year to the retailers of alcoholic liquor. These licences are neither more nor less than monopolies; for if they were granted freely to all applicants their value would dwindle away. One single example will suffice. In a small northern town a new licence was granted in 1897 to a small house valued at £3,500. On receipt of the licence the owner promptly sold the house for £24,500. Thus the small northern town lost a sum of £21,000 by a single transaction.² There are few people who realise that the patronage of the justices of the peace in this country is worth infinitely more than that of the Lord Chancellor and all the ministers of the Crown put together, and that if sale were substituted for patronage the rates in very many places would be entirely abolished and a large sum remain over for other municipal purposes.

No one supposes that the payment of an adequate price by

¹ ECONOMIC JOURNAL, March, 1899.

² See for this and many other typical instances, *The Temperance Problem*, Rowntree and Sherwell, pp. 337-346.

the licensee would conduce to the trade being carried on in a less moral and public-spirited way than the present. Nor does any part of the financial reform here indicated contain the prime demerit of novelty. The local character of licences is already recognised. In 1835, Lord John Russell proposed to transfer the patronage from the justices of the peace to town councils. In 1871, Mr. Bruce's Licensing Bill, brought forward on behalf of the Government of the day, and providing for a ten years' notice and no compensation to existing licensees, contained a clause (13) which ran as follows :

“Where a new publican's general certificate is to be granted for any licensing district, the same shall be granted to the person who offers by tender to pay for the same during the continuance of the certificate, the highest annual percentage on the annual value of his premises.”

So that if the Bill of 1871 had passed, and the proceeds of the licences had been devoted to local purposes, it may confidently be asserted that at the present moment no complaint would be heard from one end of the kingdom to the other of the intolerable burden of rates.

And yet our so-called financiers shake their heads solemnly over the increase of local and imperial expenditure, and tell the people that the only possible means of providing more revenue is by resorting to *octrois* and a protective tariff.

F. W. HIRST