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The British Tax System: Opposing Trends

Victoria Curzon Price

Abstract

This article points to the highly centralized nature of the British tax system. A first section shows how all tax law derives from Parliament, the "onlie begetter" of legally enforceable instruments. It is suggested that this system is not democratically accountable at sub-national levels of government. Reforms of the Thatcher era have resulted in the privatization of many public services, leading to the stabilization of State expenditure as a proportion of GDP. However, at the same time, both tax revenue and expenditure have become increasingly centralized. Public service tasks are determined and financed by central government, and local government is for the most part merely the agent through which government policy is realized. The creation of the Scottish and Welsh Assemblies does not alter this overall assessment. Given the high level of centralization, taxes are uniform throughout the country and there is no scope for meaningful regional fiscal competition. Since regional economic development in Britain is notoriously uneven, the author notes that fiscal uniformity does not lead to economic convergence. A final section is devoted to showing why this is not surprising and why fiscal harmonisation at a European level would be a source of growing, not reduced, disparities.

Cet article met l'accent sur la nature hautement centralisée du système fiscal britannique. Une première section montre comment toutes les lois fiscales proviennent du Parlement, la "source unique" des instruments légaux exécutoires. Nous considérons que ce système n'est pas démocrat-iquement defendable aux niveaux subnationaux de gouvernement. Les réformes de l'ère Thatcher ont conduit à une privatisation de beaucoup de services publics, entrainant une stabilisation des dépenses de l'Etat en pourcentage du PIB. Cependant, dans le meme temps, à la fois les recettes fiscales et les dépenses sont devenues de plus en plus centralisées. Les taches du service public sont définies et financées par le gouvernement central et le gouvernement local est dans la majeure partie des cas l'agent à travers lequel la politique du gouvernement s'exerce. La creation des Assemblées Ecossaises et galloises ne modifie pas cette evaluation d'ensemble. Etant donné le niveau élevé de centralisation, les impôts sont uniformes à travers le pays et il n'y a pas de possibilité pour une concurrence fiscale régionale significative. Alors que le développement économique regional en Grande Bretagne est notoirement inégal, l'auteur remarque que l'uniformité fiscale ne conduit pas à uneconvergence économique. Une section finale est consacrée à montrer pourquoi cela n'est en rien surprenant et pourquoi l'harmonisation fiscale à un niveau européen serait une source de disparités croissantes, et non décroissantes.

KEYWORDS: British tax system, Parliament, centralisation

THE BRITISH TAX SYSTEM: OPPOSING TRENDS

Victoria Curzon Price°

"(There is a) fundamental weakness in the structure and organization of local government in Britain, and finance is … the means by which these problems are brought to the surface". [1]

1. Introduction

During the past 20 years, Britain has experienced the Thatcher Revolution and its aftermath – a massive change in economic policy, not to say philosophy. This has left its mark on the British tax system in the form of two opposing trends. On the one hand, the State has withdrawn somewhat from the market place, permitting a stabilization of public expenditure as a proportion of GDP over time. Thus general government expenditure as a proportion of GDP fell from 37.5% in 1979 to 36.3% in 1999 (see Table 1, p. 596). On the other hand, Britain has become more centralized. This can be seen from Table 2. Local government expenditure (including transfers from central government) fell from 34.4% of total public expenditure to 28,3% over the same period. This trend has been accompanied by growing dependence on central government: in 1979 about half of local government expenditure was financed by central government grants; by 1998 this proportion had risen to 70% (see Table 2, p. 599). In the meantime, social security expenditure has risen from 26.2% to 36.1% over the same time period.

The rolling-back of the State was intentional. It took the form of privatization, first of nationalized industries, like steel and automobiles, then later of public utilities, which was more controversial, since many were considered to

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[1] Kay/King-1990, p. 150.

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possess features of natural monopoly.

The additional twist to centralization, however, was an accident. Mrs. Thatcher (as she then was) tried, and failed, to increase the autonomy of local government. The end result is what must be one of the most centralized fiscal arrangements ever seen in a large, modern democracy. On the other hand, many parts of the administrative structure are attractive from the tax-payer's point of view: the "PAYE" (pay-as-you-earn) system, self-assessment and the application of the tax law.

In terms of our central research interest, namely trends on the centralization-decentralization scale, the British tax system was already centralized in 1979 and has become more so since.

In terms of our ancillary question concerning fiscal competition arising from local government autonomy, one may safely say that whatever intra-local authority fiscal competition might have existed in the past, it has most definitely disappeared by now. Britain is a unitary state, with a unitary tax system, today paying only lip-service to local democracy. There is little or no scope for fiscal competition between local authorities and no incentive to "vote with one's feet" from one local council jurisdiction to another, for either people or firms. However, the British economy remains one of the most open in the world and governments since 1979 have engaged in international fiscal competition by reducing both personal and corporate taxes, in order to attract mobile resources from abroad.

This paper is divided into three parts. Part One discusses various administrative and legal aspects of the UK tax system. Part Two looks at the overall share of government in the UK economy, and the split between central and local government. And Part Three shows that a unitary tax system like that of the UK, although it provides a "level playing field", does not result in economic convergence between regions.

2. General administrative features of the British tax system

2.1. Applying the tax law

Income taxes are administered by the Inland Revenue (IR), with the head office in London, and a network of district offices to actually collect and administer taxes locally. Although the tax inspector is "local", he or she is acting for the central administration.

The tax authorities are constrained to act only within the legislative powers

as determined by Acts of Parliament. Since the UK has no (written) constitution, there are no constitutional limits on executive action. So it is up to the courts to protect people from arbitrary power[2]. They do so by making sure that any dispute arising from the administration of taxes is resolved by judges on the basis of clear legal authority (the only one being recognized is an Act of Parliament). The result, according to Morse & Williams is "a developed administrative law of taxation"[3] which attempts to strike a balance "between giving powers to the tax authorities on the one side, and on respecting rights of taxpayers on the other"[4].

This is achieved by ensuring that disputes about *either the law or the facts* can be referred to independent courts, while *unfair treatment by the tax administration* can be submitted to independent review.

Appeals against IR decisions can be made to independent tribunals called either "General Commissioners" (for simple cases) or "Special Commissioners" (for more complicated issues)[5], nominated by the Lord Chancellor (head of the independent judiciary). General Commissioners are laymen, not tax specialists. They are local people selected for their financial ability and experience. They meet in groups in order to hear cases. Procedure is informal. The Special Commissioners are tax experts drawn from the professions (chartered accountants, solicitors, advocates, and even former IR officials). They may sit singly to hear cases, but will sit as a group to hear particularly difficult cases. Their proceedings are formal and they are based in London. Tax payers can choose between the General and Special Commissioners, but they in turn can transfer cases between themselves. They can dismiss, or alter, any assessment in any way they consider justified.

Appeal from the Commissioners to the general courts can only be made on a question of law, not of fact. (This is intended to prevent judges from deciding tax questions as such, but the distinction has in turn given rise to disputes).

Cases can continue up through the Court of Appeal and up to the House of Lords, as a final court, or if a point of European law is involved (essentially Customs & Excise, or VAT) they may end up with the European Court of Justice.

A tax payer may choose to appeal to the Revenue Adjudicator, whose office is "informal"[6]. He is appointed by, but independent of, the Internal Revenue[7]. This gets a case reopened and looked at again, instead of taking matters up to higher courts. There is also a Parliamentary Ombudsman, who can review complaints of taxpayers. The Parliamentary Ombudsman is available to hear

[2] Morse/Williams-2000, pp. 15-16.

[3] *Ibid.*

[4] *Ibid.*

[5] Morse/Williams-2000, pp. 16-17.

[6] Morse/Williams-2000, p. 18.

complaints concerning maladministration by any government department, including the tax department.

2.2. Self assessment and the PAYE system

In 1994 the UK introduced a fundamental reform of personal tax administration by adopting a system of self assessment by the taxpayer, who declares his income and capital gains and then computes his own tax liability. Before this reform, tax payers would fill out their income declaration, and the Revenue would determine their tax liability. The current system is an improvement in that it lays the burden of proof of the exact amount of tax liability squarely on the Inland Revenue. The IR can question the self-assessment for a period of up to 12 months and the tax-payer may equally amend his return within a period of 12 months (though not if the IR has launched an inquiry). The IR can go back five years to alter an assessment[8] but in cases of fraud or wilful default, the time limit extends to 20 years.

If the IR inspector and the tax payer do not agree, the parties can appeal to the General, or to the Special Commissioners (see above).

Income tax is deducted at source for all employees in the UK by the employer, who hands over the tax collected to the Inland Revenue ("Pay as you earn", or PAYE system). Every employed person is given a code number by the tax inspector, and this tells the employer the amount of allowances, relief or whatever other adjustments need to be made. Tax is paid on current income, and is collected bit by bit as the year goes by. It is a "painless" tax, since tax-payers never get to see their full pay (especially as social insurance contributions are similarly deducted at the source). The employer acts as an unpaid tax collector for the Revenue. If someone ends the year having paid too much tax, and can convince the Revenue of his case, he gets a refund or a tax credit for the next year. For obvious reasons, no complaints are made in the other direction.

2.3. Residence

The United Kingdom abolished all exchange controls on capital movements in 1979. Since that time, UK residents have been free to invest their savings anywhere in the world, and conversely, the UK welcomes any savings that foreigners may wish to invest in the UK. The success of the City of London is in part due to the fact that most other EU countries did not adopt similar freedoms until the 1990's. Since 1979, however, the UK Revenue has been concerned with the problem of residence for the purpose of tax, and the possibilities for tax evasion that a more liberal regime for capital flows allows.

[7] Morse/Williams-2000, pp. 62.

[8] Morse/Williams-2000, p. 61.

The UK follows general world practice in ignoring the nationality of a taxpayer and concentrating on *where the person is living*. Individuals are treated differently from corporations.

As far as individuals are concerned, the UK uses three different concepts: residence, ordinary residence and domicile. Residence is where the person is living *now*. Ordinary residence is where the person is *normally living*. Domicile is where the person has their *permanent home*. For many people, there is no difference between these three concepts. But in an increasingly mobile and global world, many high-income individuals may fit all three of these definitions in different places at the same time.

The UK taxes *residents* on their world wide income, and taxes *non-residents* on income arising in the UK. Most countries apply the same rule, giving rise to the possibility of double taxation. Hence a dense network of bilateral double tax agreements whose purpose is to make allowance for taxes which residents have already paid to a foreign tax authority, or which non-residents have paid to the Inland Revenue.

If a person is temporarily in the UK (less than 183 days a year) they are considered non-resident. However, if they own a home in the UK, they may be treated as a resident, unless they can prove that they work full-time abroad. Frequent visits to the UK are also suspect! They must not be part of the individual's "habit of life"[9]. If a person leaves the UK for the purpose of occasional residence abroad, they are still considered to be resident in the UK by the UK tax authorities. They may find themselves subject to two simultaneous tax jurisdictions as a result. The relevant double tax treaty must be consulted. The UK tax authorities will not "hound" a British resident who decides to set up residence in a foreign country, but will require evidence that the move is permanent (see above for the various definitions of residence).

As for corporations, any company incorporated under the laws of the United Kingdom is resident there for tax purposes. A company, however, may have more than one residence, and pay tax in several jurisdictions (with abatements arising from double tax treaties).

Domicile, according to Morse & Williams has no special meaning in UK tax law, but is a source of confusion because of the French term "domicile" (residence in English).

It is British Government policy not to subject interest and dividends ("Schedule D "interest annuities or annual payments") to withholding taxes, but to seek enforcement of tax obligations through the exchange of information between tax authorities[10].

[9] Morse/Williams-2000, pp. 406-409.

[10] Morse/Williams-2000, p. 415.

Concerning the transfer of assets abroad, in order to combat tax evasion, the Inland Revenue will deem an individual to be receiving taxable income even if that income remains abroad and is not repatriated. Again, the bilateral double tax treaty will provide the exact status of such income and its tax liability. The individual can escape this extraterritorial tax if he can prove that tax avoidance was not the purpose of the transfer of assets abroad.

The Treasury can still stop a company resident in the UK from becoming a non-resident, in particular in a non-EU country[11]. Any company resident outside the UK in a low tax area, but which is controlled by persons resident in the UK, is known as a "controlled foreign company" and its profits will be apportioned among those possessing an interest in the company, and taxed accordingly. This covers offshore mutual funds set up to minimize tax exposure.

The UK tax system is tough but fair. The taxpayer gets a fair chance to seek redress from his tax inspector. However, the UK taxpayer is helpless to affect the overall tax-and-spend picture, as we shall see in a moment. So centralized has the tax system become that the British public can fairly be said to have lost all control over the size of government, or the tasks which government can undertake, except for such control as may be exercised once every 4 or 5 years at general elections. The British electorate were lucky to have fallen upon Mrs. Thatcher, who most uncharacteristically for a politician rolled back the State. But can they keep Leviathan caged in the long run?

3. Situation before the Thatcher Revolution

Even before 1979, on the revenue side, local "authorities" had very little power to tax. Their tax base lay in property (of households and firms), which lay 100% in their preserve. This had proved adequate for centuries, but the expansion of the State after World War II, and the expansion of the tasks devolved upon local authorities by the central government, made local finances more and more fragile. The shortfall in revenue was made up by central government. However, this automatic "grant" was not entirely without strings.

After a while, on the spending side, most of the tasks of local government were also set by central government. Westminster (Parliament) set the broad agenda and Whitehall (the Civil Service, composed of powerful centralized Ministries) laid down the operational details. Local governments were the local executive arm of the central government for education, social services, housing, law and order. Policy was set by the central government.

In addition, central government also worked through "quasi-autonomous, non-governmental bodies" or "Quangos" , which were functional, nation-wide

[11] Morse/Williams-2000, pp. 419-421.

bodies set up to execute the will of central government, and which ran public sector entities like British Steel, British Motor Company, British Gas, British Telecoms, cultural, heritage and sports activities.

"Quangos" are, in fact, another feature of the centralized system of government in the UK. Since there is nothing between the central government and some 500 local authorities, intermediate functional structures are needed to execute policy and provide public services which require a larger scale for efficiency than the catchment areas provided by local authorities (this looks like a perverse application of the principle of subsidiarity, since a "catchment area" of 54 million people is surely too large for efficiency in all but a very few matters). Quangos, or ad hoc agencies, are described by Hanson and Walles as "characterized by specialization of function, varying degrees of autonomy, and whole or partial exemption from the normal processes of accountability to Parliament, through Ministers"[12]. Although the Thatcher government radically reduced their number through privatization, many remain to administer agriculture, transport, environment, social services, education and health. Their purpose is to ensure a uniform level of public services throughout the Kingdom.

Another feature of British centralization is the phenomenon of "delegated legislation", according to which administrative bodies, like the central Civil Service, Quangos and even in a limited way, local authorities, make rules and regulations.

According to Hanson and Walles[13], while Parliament is the "onlie begetter" of legally-enforceable instruments, it lacks "the time, the will and the knowledge to ensure that they accurately express its original intentions". It therefore governs through "delegated legislation" and gives "rule-making powers to administrative agencies – principally Ministries and local authorities"[14]. This relieves Parliament of the minor details of law making, but does not devolve true power to lower levels of government (we shall not be discussing here the creation of the Scottish and Welsh Assemblies, which are indeed a revolution in the British system of government, but which have done nothing to alter the nature of local government as such, nor to change the nature of legislative delegation). The congruence of administrative rules with the underlying Parliamentary legislation can of course be tested in the Courts.

According to Hanson and Walles[15], it is Ministers who make the appointments to Quangos (about 8,400 paid jobs lie in their patronage), reinforcing the impression of a top-down power structure and lack of democratic representation. If these agencies were merely of an administrative nature, there would already be grounds for objection, but they are also empowered by Ministers

[12] Hanson/Walles-1984, p. 191.

[13] Hanson/Walles-1984, p. 282.

[14] Hanson/Walles-1984, p. 279.

[15] Hanson/Walles-1984, p. 196.

(who are empowered by Parliament) to devise doubly-delegated legislation in the form of rules and orders. This lack of separation of powers is surely dangerous from a public choice perspective.

Rowley had this to say about this system on the eve of the Thatcher revolution:

"The political system in Britain … has become excessively vulnerable to powerful interest groups – notably the public sector trade unions and professional organisations as well as government bureaucracy – which together wield immense economic power largely because they have been given monopoly power by statute… With government expenditure accounting for more than 50 per cent of gross national product, and with the private sector suffering from high taxation, from the crowding-out of its own investment programmes and from an inadequate social infrastructure, it is not surprising that Britain is rapidly heading towards a position of comparative under-development".**[16]**

On the other hand, since the Thatcher "revolution", the role of the State has been radically cut back. After dismantling trade-union privileges (an essential pre-requisite), the privatization of loss-making nationalized industries, such as coal, steel and automobiles, wiped out dozens of Quangos at a stroke. Privatization of public (monopoly) utilities (energy, telecommunications etc.) followed. While huge swathes of the economy were restored to the market place, the need arose to regulate privatized natural monopolies, or at least preside over oligopolistic competitive processes**[17]**. This gave rise to a new breed of Quango, the specialist regulator of quasi-monopolies, like the privatized electricity and gas sectors.

TABLE 1
UK Central/local revenue & expenditure as % GDP

	1979	**1989**	**1998**	**1999**
General Gvt. Expenditure	37,5	34,1	36,5	36,3
Transfers to local government	5,9	5,1	7,2	7,4
Local government expenditure	12,9	12,0	10,4	n.a.
of which social security expenditure	9,8	11,7	11,1	13,1

Source:IMF, Government Finance Statistics, various issues
IMF, International Financial Statistics, various issues

But the essential work had been accomplished: the State had been rolled back, both at central and at local level. Thus general government expenditure fell from

[16] Rowley-1979, p. 112.

[17] See Beesley-1994, Beesley-1996, Beesley-1997 and Blundell/Robinson-1999.

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37,5% of GDP in 1979 to 34.1% in 1989. It has risen again since, to 36,3% in 1999, but that will surprise no one (see Table 1, p. 596). During the same period, the share of local government expenditure fell from 13% of GDP to 10.4% in 1998.

3.1. Reform of local government after 1979

The Thatcher government introduced major local government reforms through the Local Government, Planning and Land Act of 1980 and the Local Government Act of 1988. These pieces of legislation preceded Mrs. Thatcher's ill-fated attempt to reform local government finances and have proved reasonably long-lived and successful. They revolutionized the way public services are organized in the UK and contributed to halting the steady upward trend of government expenditure.

Traditionally, local authorities and Quangos provided services to the public by employing staff directly. Carnaghan and Bracewell-Milnes[18] report that the proportion of the employed labour force working for local government expanded from 5.6% in 1938 to over 12 % in 1982 (a peak). Since then the share has fallen back to "only" 10%. During the same period, the share of central government expenditure on wages and salaries fell more starkly still, from 4.9% of GDP in 1979 to 2.6% in 1998, but this appears to be due almost entirely to cuts in defence expenditure (see IMF *GFS*). It is already a considerable achievement to have stabilized public-sector employment: it is too much to hope for it to fall.

The two Local Government Acts of 1980 and 1988 introduced compulsory competitive tendering for local authorities and Quangos. The objective was not so much to reduce public sector employment *per se*, but to free the country from the endemic culture of rolling strikes by public-sector employees, who enjoyed a monopoly supply position in all sorts of areas vital to public welfare, and to try to control the spiralling costs and poor standard of public services supplied by quangos and local authorities.

To begin with, competitive tendering was limited to only a few services mainly related to non-emergency construction and maintenance of highways and buildings. A quota of 40% of such work could be reserved to local authority employees. Local authorities were obliged to keep separate accounts for such work, so that they could compare their internal costs with those offered by private contractors. However, Carnaghan and Bracewell-Milnes report that local authorities had no difficulty in avoiding competitive tendering, "because of the 40 per cent competition-free allowance for non-emergency work and the exclusion of work defined as emergencies"[19]. According to a study by the Audit Commission in

18 Carnaghan/Bracewell-Milnes-1993, p. 22.

19 Carnaghan/Bracewell-Milnes-1993, p. 29.

20 Carnaghan/Bracewell-Milnes-1993, p. 29.

1989-90 of work done internally by some of London's local authorities, "many were subject to low productivity, poor attendance, inadequate supervision, high overheads, poor quality of service, (and) ineffective working practices"[20]. But there was much resistance within local authorities themselves to adopting competitive tendering, not to mention strenuous trade union opposition, especially from public-sector employees. Many local authorities were controlled by the Labour Party, and simmering resentment which built up during the 1980's boiled over in 1990-91 in outright rebellion against the hated poll tax.

But we are not there yet.

In 1988 the Thatcher government decided to make competitive tendering compulsory, and to widen its scope.

Authorities (local councils and Quangos) now must invite tenders from at least three private contractors, and may provide the services themselves only if they have won the contract in competition with the outside contractors[21] for all "functional work". The latter is broadly defined and covers (in addition to building and maintenance of roads and buildings) refuse collection, cleaning and maintenance of all types, care of public parks, spaces and sports facilities, catering, repair and maintenance of vehicles, street lighting, and maintenance of sewers. Since the Act applied to Quangos as well as local authorities, schools and hospitals were also involved.

According to Carnaghan and Bracewell-Milnes compulsory competitive tendering covers about 8% of local government expenditure[22], but could be expanded to cover many other areas, such as fire brigades, police and professional services. However, the process of radical political reform was halted over the poll tax problem and has never returned.

3.2. The poll-tax story

As we have already seen, Britain's central government ("Westminster and Whitehall") administers few public affairs directly. It works through Quangos and local authorities. Along with the notoriously poor quality of the services thus provided, the Thatcher government became increasingly concerned with its lack of control over local government expenditure. Not only did local government employees strenuously resist the Thatcher government's pressure to reform, but the system of local government finance provided no incentive to reduce expenditure. Rather the contrary, in fact.

Property and other local taxes accounted for 54% of local government expenditure in 1979-89 (See Table 2). The remaining 46% came from central

[21] Carnaghan/Bracewell-Milnes-1993, p. 42.

[22] Carnaghan/Bracewell-Milnes-1993, pp. 64-65.

government in the form of grants, to execute central government policy. As a result the central government suffered from a typical agency problem: how to make sure that the agent was not wasting too much money in executing its tasks? Or that it wasn't using some of the principal's money to cross-subsidize some of its own pet projects?

Table 2
UK Central/local revenue & expenditure as % government expenditure

	1979	**1989**	**1998**	**1999**
General Gvt. Expenditure	100,0	100,0	100,0	100,0
Transfers to local government	15,7	14,9	19,8	20,3
Local government expenditure	34,4	35,2	28,3	n.a.
% financed by transfers from central government	45,7	42,4	69.6	n.a.
% financd by local property and other taxes	54,3	57,6	30,4	n.a.
Of which social security expenditure	26,2	34,4	34,0	36,1

Source: Same as Table 1

As if this were not enough, the executing agent was elected by a college of voters the majority of whom paid no local taxes at all (because they owned no property) or because their incomes fell below the statutory minimum. Out of 35 million voters, 20 million paid no rates at all and 3 million paid rates at reduced rates[23]. The reliance on property taxes as a principal source of income for local government went back centuries, but by now, most local council residents were quite unconcerned about their local government overspending, because someone else picked up the bill. Property-owners, a structural minority, were consistently out-voted. Furthermore, many local councils made sure that they had a permanent built-in Labour majority by embarking on large-scale social housing projects and attracting thereby a large population dependent on social welfare, which itself was administered by the local authority on behalf of the central government. They could thus claim a larger central government grant, to make up the shortfall between the cost of their social programmes and the revenue coming from property taxes ("rates"). The Thatcher government was unable to control public expenditure as a whole, because local authorities were out of control.

To begin with, the Thatcher government attempted to control local expenditure by refusing to increase the central government grant. Local governments (especially those controlled by the Labour Party) responded by raising local property taxes ("rates"), especially on business firms. This in turn reduced the central government's corporate tax take, since local property taxes could be off-set against corporate income.

The Thatcher government could do one of two things: expand local governments' tax base, so that they could finance expenditure 100 per cent

23 Thatcher-1993, p. 645.

through local taxes (this would have achieved fiscal coherence, electoral reasonability and political responsiveness to different local needs) OR continue with the existing system of central government grants, but exercise much more central control over how the money was spent.

The Thatcher government tried the first (democratic and decentralized) option.

Business property tax was altered, and the rates were set at the national, rather than local levels of government. The residential property tax was replaced by a *community charge* – an equal tax on each adult[24]. The central government grant was set at an "assessed needs" level. Any spending in excess of this amount had to be met from the community charge.

The community charge part of the experiment was a fiasco. It brought down the Thatcher government and was itself withdrawn, leaving the less controversial, but highly centralizing items in place.

The current local tax system, introduced in 1993, is a function of property values once again, but modulated to take account of the number of adults in the household. Tenants also pay a community charge, but unlike the poll tax, this takes account of their income. Local councils' right to determine the rate system has been curtailed[25]. This is known as "rate-capping", which gives an extra centralizing twist to the whole story. Today, property and community taxes account for no more than 30% of local government expenditure, as compared with 42% in 1989 (see Table 2, p. 599), while grants from central government have risen from 46% of total local expenditure in 1979 to 70% in 1998.

Local governments are more subservient than ever to Westminster, Whitehall, and the Quango system. Not only have they lost the right to tax corporate property, but even the central government grant has been "capped". Every year, each local council receives a "standard spending assessment" which, according to Else, is supposed to "reflect the central government's view of what individual authorities need to spend to provide common service levels consistent with the central government's own public expenditure policies"[26]. Else also reports that whatever the past history of local councils (whether traditionally over- or under-spenders), the tendency is for the expenditure of all authorities to converge on their standard spending assessment. This means that they are all now "under control" and that the scope for fiscal competition between them has been eliminated.

Without any serious political debate on the matter, the British public threw away its only opportunity in recent years to wrest political and fiscal responsibility from the central government and to develop a proper local government system worthy of its name.

24 Gale-1997, p. 363.

25 Gale-1997, p. 365.

26 Else-1996, p. 167.

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4. Fiscal uniformity does not lead to economic convergence

The UK case shows that fiscal uniformity does not, of course, lead to convergence of outcomes, since regional disparities are as great as ever in the UK, and growing fast. In fact, a moment's reflexion will confirm that to apply identical tax rates to different regional entities can only result in *growing* disparities. This in itself should be sufficient to demonstrate that fiscal uniformity is both senseless (if the purpose is to achieve economic convergence) and anti-democratic (if one believes that local government is better able to reflect local needs in terms of the supply of public goods than a distant, centralized government).

Fiscal uniformity across regions is senseless because to harmonize only one variable in the complete set of the many variables which determine such outcomes as regional economic activity, inward and outward investments, per capita incomes and the like, actually *deprives* a backward region with the means to compete with more prosperous regions.

Let us develop this point.

If we agree that governments will expand as far as their "taxing capacity" (T) allows, and that T depends on many things, but at least partly on spontaneous economic growth (G), attractiveness of general life-style (L) and quality of public services (P), then we can say that public authorities will achieve an equilibrium when $T = G+L+P$. If $T < G+L+P$, mobile resources will be attracted to this spot, economic growth will occur, land prices will rise and there will be scope for further public sector growth which politicians will quickly spot. T will soon equal G+L+P again. If $T > G+L+P$, mobile resources will flee, the local economy will stagnate and public authorities will have to think hard about what to do to make their area attractive once more. They can act on T, but they could also act on G, L or P, and in fact the disequilibrium could stem from any of these factors.

Similarly, let us assume that in some parts of the world G+L+P happen to be high, while they are low in others. This means that T can be high in some *h* areas, but must be lower in other *l* areas, without violating the equilibrium condition above.

It therefore *makes no sense at all* to harmonize T between regions with different economic capacities. In fact, harmonizing T between *h* and *l* would set up unbearable counter pressures. If T were harmonized at the *l*-level, all mobile resources would flood into *h*. If T were set at the *h*-level, *l* would suffer an exodus of mobile resources. Only if T can reflect the relative attractiveness of locations in *h* and *l* respectively will mobile resources stay put.

It is notorious that in the UK inter-regional migration is occurring at such a rate that London and the South East are exploding, while parts of the North and West are imploding. This may be because regions have lost any capacity to set public policies, and local taxes, in line with local economic realities.

The same reasoning applies, with even more strength, to the question of harmonizing taxes across Europe and especially within Euroland. The members of the Euro area have voluntarily abandoned monetary policy, and their budgetary policy (balance between public revenues and public expenditures) is theoretically curtailed by the Stability and Growth Pact. What remains is the determination long-term structural fiscal policy. It would be a real disaster if, in their wisdom, governments were to agree to harmonize this last important variable in achieving equilibrium in the Euro area. "One size fits all" is already a doubtful slogan for monetary policy on a European scale. It certainly cannot apply to personal and corporate tax without generating large, wasteful and disruptive factor movements within Europe.

5. Conclusion

The Thatcher "Revolution" lowered taxes, but turned the United Kingdom into one of the most highly centralized countries in the world from the fiscal point of view. From this experience, two general conclusions can be drawn.

First, when taxes are high, "Laffer curve" effects are likely. The United Kingdom lowered both personal and corporate taxes in the 1980s and thereafter enjoyed a much improved rate of economic growth. This is but circumstantial evidence, but it is supported by the Irish experience[27].

Secondly, as shown above, applying a uniform tax system over an area as large as the United Kingdom, does not lead to economic convergence between regions.

Both these points are worthy of consideration in the Europe of the future. Many European countries could probably benefit from "Laffer curve" effects were they to reduce their high tax rates, both average and marginal.

They are challenged to do just that. From May 1 2004, non-uniform, not to say exceedingly dissimilar, tax rates and systems will be in competition with each other in EU-25. Slovakia and the Baltic states have introduced a "flat tax" system, after Russia showed the way in 2000, while Poland, Hungary and the Czech Republic are offering very competitive corporate tax rates of between 18% to 24%[28].

This fiscal competition is likely to be much resisted by the high-tax founding members of the EU, in particular, France and Germany. They will press for European tax harmonization in the name of "coherence" and "convergence". They will try to persuade the European Court of Justice that different tax regimes across

27 See Brownlow-2004, pp. 22-23 and pp. 27-29.

28 Mitchell-2004,.p. 35.

Europe are incompatible with the “four freedoms” (free movement of goods, capital, people and provision of services) upon which the entire structure of European integration is based.

But one should never forget that trade is based on differences, not similarities. Distortions of trade – which no one can condone – arise from *discriminatory* laws and the arbitrary application of general laws within a given territorial jurisdiction, not from mere differences in general laws applied over a set of territories. These differences have always existed and reflect the varied cultural traditions of the societies which generated the formal laws in the first place.

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