

Example 4.1

Great Britain's Lump-sum Community Charge

Lump-sum taxes had their moment in the sun in Great Britain during the third administration of Prime Minister Margaret Thatcher. Thatcher's government enacted a law in 1989 requiring local authorities to replace their system of local property taxes based on rental values with a lump-sum head or poll tax.¹ Every adult would now pay the same amount of tax, called the Community Charge, to the local government, with the amount determined by each locality. The only exceptions were students, pensioners and the unemployed, who received 80% rebates on the tax. The Community Charge was instituted in Scotland in 1989 and in England and Wales in 1990.²

PERCEIVED ADVANTAGES OF THE COMMUNITY CHARGE

Thatcher and her Conservative Party colleagues perceived that the Community Charge would have both equity and efficiency advantages relative to the local property taxes. Both advantages arose from the same source – that the Community Charge was a tax levied on the benefits-received principle of taxation.

Equity Advantages

As the name suggests, the benefits-received principle says people should pay directly for the public services they receive from their governments. This is widely viewed as a fair way to levy taxes in capitalist countries because this is how the market asks people to pay for goods and services. If you want the benefits of a particular good or service, you buy it; if not, you do not buy it. Some public expenditures, such as transfers to the poor,

¹ Great Britain has a unitary as opposed to a federal government, so that the national government controls local tax policies.

² J. Meadowcroft, *The Failure of the Poll Tax and Classical Liberal Political Economy: Lessons for the Future*, *The Future of Local Government*, Institute of Economic Affairs, Blackwell Publishing, Oxford, 2006, p. 25. This example relies heavily on Meadowcroft's analysis of the Community Charge.

cannot be paid for on a benefits-received basis. There would be no net transfers if the poor were taxed for the transfers they received. A different equity principle is needed when designing taxes to pay for transfers. But the idea is that if the benefits-received principle can be applied to particular goods and services, it should be.

Regarding the lump-sum Community Charge, not everyone within a locality receives the same benefits from the local government services. For example, some people do not have children in the local schools. Nonetheless, charging everyone the same tax was felt to be fairer than the existing system of property taxes, under which there had developed a large disconnect between taxes paid and services received. Only 18 million of the 35 million voters in England paid local taxes, and only 34% of the 18 million paid the full rates because there were numerous rebates available. Also, businesses paid 60% of all local taxes yet they had no direct say in local governance.³ The Community Charge was viewed as a much closer approximation to the spirit of the benefits-received principle than the existing property taxes and thus a much fairer tax.

■ Efficiency Advantages

There were a number of perceived efficiency advantages in basing local taxes more closely on the benefits-received principle. First, the Community Charge would bring the discipline of the marketplace into the public sector by forcing people to pay for the services they receive. Under the existing property tax system, the local officials could pursue their own political agendas, pushing expenditure programs that they desired knowing that the majority would be likely to approve because so many voters would not have pay for the expenditures. Under the Community Charge, in contrast, increases in public expenditures would require increases in taxes for everyone. A majority of voters would no longer agree to programs unless they were willing to pay for them. Second, public officials now had an incentive to contract out some local public services to private firms if the private sector could offer the services more cheaply in order to keep the Community Charge as low as possible. For both reasons, it was felt that the local officials would begin to act more like public administrators giving people the services they wanted at the lowest possible costs rather than as politicians pushing their own favorite programs. Finally, we noted in Chapter 2 the conjecture by Charles Tiebout that a system of local governments promote efficiency by more closely matching people's preferences for public services to the public services they actually receive. By tying taxes directly to the public services provided, the Community Charge would encourage what economists refer to as *Tiebout sorting*. People who like the local public services and are willing to pay for them would move to high-tax/ high-public service communities. Those who were less willing to pay for the local public services would move to low-tax/low-public service communities. As a result, more people would live in communities that more closely

³ *Ibid.*, p. 26.

matched their preferences for public services, and everyone would be made better off in the process.

THE REACTION

The verdict on the Community Charge came swiftly – it was a disaster. Protestors gathered throughout the land and millions of people refused to pay the tax. A protest in Trafalgar Square involving over 200,000 people escalated into one of the worst riots in British history. Voters held the national government responsible for the tax and the Conservative Party responded in an attempt to remain in power. Just seven months after the enactment of the tax, the government increased the VAT from 15% to 17.5% in order to give each adult a £140 reduction in their Community Charge bill. But the voters made it known that they were still not satisfied⁴, and Thatcher's plummeting popularity led to a direct leadership challenge from Michael Heseltine. Though he was unsuccessful, Thatcher was damaged past repair and she resigned in 1990. In the leadership election that followed, all candidates promised to repeal the tax, and the eventual victor, John Major, replaced it with the Council Tax in 1993. The Council Tax, still in place today, is a system of local tax rates that were much like the property tax rates that the Community Charge had replaced. Though the Conservative government held on to power until 1997, it arguably never recovered fully from the Poll Tax debacle.

What went wrong? Whenever outrage against a public policy is so broad and vehement as the reaction to the Community Charge was, you can be sure that people's sense of equity is offended. There is another principle of equity in taxation that is as widely embraced as the benefits-received principle: the ability-to-pay principle. It says that people should pay taxes in accordance with their ability to pay, that is, in accordance with their incomes or wealth. (The ability-to-pay principle is discussed in Chapter 11 of the textbook.) As it happened, the Community Charge led to huge changes in most people's tax liabilities. Sixty percent of the voters experienced at least a 20% change in their local tax liabilities, with much of the tax burden shifted from high to low-income voters.⁵ This redistribution of the tax burden was seen as highly unfair. The ability-to-pay principle had clearly trumped the benefits-received principle in the public's view of the fairness of the new head tax.

The perceived efficiency advantages of the Community Charge were obviously not sufficient to overcome the public's sense that the tax was unfair. A likely reason for this was that any efficiencies resulting from the tax would take some time to evolve, whereas voters immediately experienced the inequity of the tax. In any event, the tax was not in place long enough to test its efficiency properties.

⁴ *Ibid.*, p. 28.

⁵ *Ibid.*, p. 27.

That Britain's experiment with this lump-sum tax could bring down the Thatcher government so quickly was really quite remarkable. Margaret Thatcher led the government from 1979 to 1990, the longest term of any Prime Minister since 1827, and had been extremely popular until the Community Charge undid her. One suspects that the lump-sum head tax has been relegated to the dustbin of history in light of the British experience.