

‘Financing Our Local Authorities’ – David Healy (Dublin City Council)

This paper examines developments in the sources of income for local government in Ireland during the period 1977 and 2006. As part of this paper, the principal sources of local authority revenue will be analysed and I intend to discuss the circumstances, which have resulted in a financing system that is highly reliant on the support of central government. The various reports commissioned during the period will also be studied to see what bearing they have had on central government decision making.

Sources of Revenue

In Ireland in 2004, spending in the local government sector amounted to almost €7.5 billion in terms of current and capital schemes and projects. To put this figure in context, it amounts to approximately 5% of the Gross Domestic Product for that year. Funding for local government has been a constant source of debate in Ireland and several reports published in the last three decades have all highlighted the need for an independent source of revenue for local authorities to be generated at local level. Currently, there are three primary sources of local government financing which are universal amongst most countries. They are:

- Local Taxation;
- Central Government; Grants and
- Charges for Goods and Services.

With perhaps the addition of borrowing, these three sources provide local government with the bulk of its finances. In Ireland, local taxation is levied through rates on commercial properties. Commercial rates are paid on certain kinds of fixed or immovable property including buildings, factories, railways, canals and mines but domestic dwellings are excluded.¹ Rates are not used for any particular services but are designed to meet the deficiencies arising in local authority budgets and it is worth noting also that

¹ Commercial Rates are affected by two factors: ‘rateable valuation’ and the ‘annual rate on valuation’. The rateable valuation of any property is determined by the Commissioner of Valuation. More often than not, it is based on the estimate of the likely rent that a tenant would have to pay on an annual basis. The Annual Rate on Valuation (formerly known as ‘the rate in the pound’) is essentially a multiplier determined by the Council at the Annual Budget Meeting. Accordingly, a rate assessment is determined by multiplying the rateable valuation by the annual rate on valuation.

they are ‘not related to specific benefits received by the individual ratepayer since the benefits of local expenditure are not confined to ratepayers.’² Davis explains that the deficiency is the ‘element of the estimated expenditure not met from either state grants or the local authority’s own resources from goods and services’.³ Currently, commercial rates provide the smallest percentage of revenue to local government in Ireland. Government grants on the other hand account for the highest portion of revenue and are dispensed in a number of forms: the Local Government Fund and through other Grants/Subsidies. The former is used to fund General-Purpose Grants and Non-National Road Grants Programme, while the latter is funded by a number of different Government Departments and addresses different areas of local authority operations, covering grants for road works, water supply and sewerage schemes as well as grants for housing. The final component of local government funding comprises charges for goods and services and includes rents and repayments, agency services, commercial water/waste charges along with environmental charges.

In a comparative context, other countries place a much greater emphasis on local taxation than Ireland. As part of its study on local government financing, Indecon Consultants addressed the fiscal discretion and autonomy of local government in other countries and found that Ireland had a much more centralised funding system than some other EU members and that local sources of funding account for a smaller percentage of local government revenue. For instance, taxes by local government as a percentage of GDP were 0.6% in Ireland compared with an EU average of 3.9% and local taxes amounted to 2.3% of all taxes compared to an average of 9.8% for the EU 25 as a whole.⁴ Gallagher et al comment that one of the best ways of differentiating between countries in terms of the ‘degree of local autonomy has to do with how much freedom’ local government has to raise money from various sources ‘as they please, and then to spend it as they see fit’.⁵ Such outlets are limited in Irish local government.

² *Review of Rating Law: Report of the Working Group*, (Dublin, 2001) p. 5

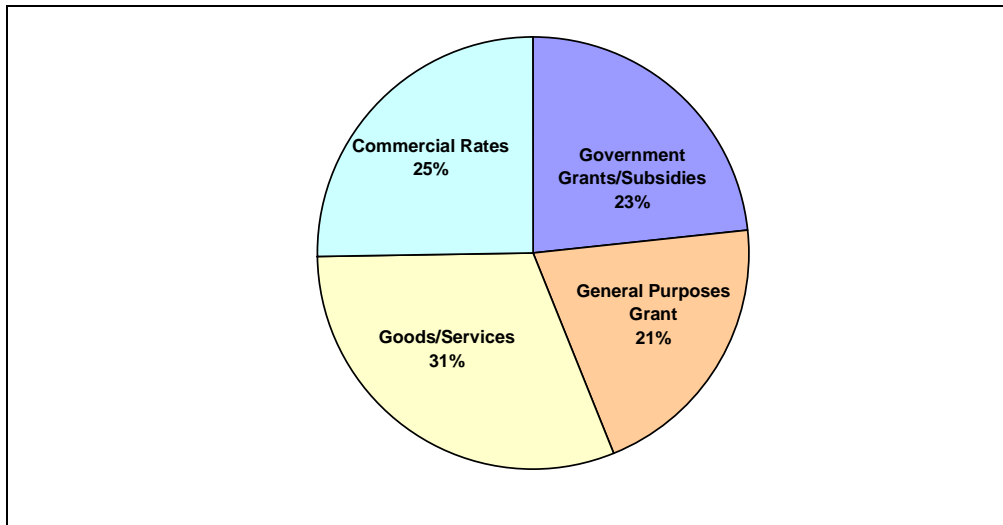
³ Davis, Tony, ‘Local Government Finance: The Financial Process’ in M. Callanan and J.F. Keogan (eds), *Local Government in Ireland: Inside Out*, (Dublin, 2003) p. 341

⁴ Indecon, (2006) p. 41

⁵ Gallagher, M, Laver, M and Mair, Peter, *Representative Government in Modern Europe, Institutions, Parties and Governments*, (New York, 2006) p. 180

In 2004, central funding in the form of government grants and subsidies along with the General Purposes Grant accounted for forty-four per cent of local authority funding compared to thirty-one per cent provided from charges for goods and services and twenty-five per cent being derived from commercial rates. (See figure 1.1 below)

Figure 1.1 Sources of Funding for Local Government Current Expenditure 2004



Source: Indecon, (2006) p. ii

However, up until the mid 1970s at least, Local Authorities commanded greater discretion over their revenue generating capabilities. For instance, in 1976 local authorities generated sixty-two per cent of their revenues locally and were only dependent on government grants for thirty-eight per cent of their overall revenue. The situation changed dramatically following the removal of the onus of paying domestic rates, a liability which was transferred to central government. The subsequent decade witnessed a very high degree of reliance on central funding by local authorities. By 1982 local authorities were dependent on government funding for sixty-seven per cent of their revenue with other sources and rates making up the remaining thirty-three per cent. Analysis of the following table reveals the make-up of local authority funding at various intervals from 1976 up until recent times. (See figure 1.2 below)

Figure 1.2 (%) Components of Local Government Finance

	1976	1982	1987	1994	1998	2002	2004
Rates	41	12	14	26	25	24	25
Government Grants	38	67	61	39	45	47	44
Other*	21	21	25	35	30	29	31

* Other would include charges for goods/services and includes rents and repayments

Source: Department of the Environment, Heritage and Local Government, Returns of Local Taxation and Local Authority Budgets

In order to understand why the financing of Irish local government is so centralised, it is necessary to analyse the events, which have contributed to the current system. In June 1978, the Minister for Local Government, Sylvester Barrett, T.D., announced to the Dail that:

‘The need to modify the rating system in its impact on domestic property has thus been frequently admitted in the past. The several investigations and studies of the rating system undertaken in recent years have been prompted more than anything else by a basic dissatisfaction with the way in which rates bore on householders. We [the Government] are removing once and for all the burden of rates from over 850,000 householders and other persons benefiting from the new reliefs’.⁶

The above assessment reflected accurately the promise, which Fianna Fail had made in the run up to the 1977 General Election regarding the issue of domestic rates. It was followed shortly after by the passing of the Local Government (Financial Provisions) Act. Despite the generally understood belief that the Act marked the ‘abolition’ of domestic rates, this is not in fact the case. The reality is that rates on domestic dwellings were not abolished, but rather the liability for paying them transferred from ratepayers to central government. In addition to domestic dwellings, secondary schools, community halls and farm buildings were also derated as part of this act. Although it was a Fianna Fail led government that had removed the onus of paying rates on domestic dwellings, the other political parties in Dail Eireann had no ideological opposition to this plan. In

⁶ Dail Debates, Vol. 307, 8th June 1978 Col 849 - 850

fact, the previous Fine Gael/Labour Coalition Government had already made overtures with regard to the removal of domestic rates and it was certainly a part of their agenda.

Towards Centralisation

The aftermath of the 1978 Act witnessed the introduction of the Rate Support Grant (RSG) by the Government. The grant in relief of domestic rates sought to make up for the shortfall in domestic rate revenue for local authorities. In theory, the money lost from domestic rates was to be recoupable in full from the exchequer. The implementation of this new system meant that in practice, local authorities could determine their own grant allocation by increasing the rate poundage. Accordingly, the Government introduced a cap on rate poundage increases between 1978 and 1981, thus preventing local authorities from deciding their own level of grant support and also protecting the remaining ratepayers.⁷ Up until 1982, the Government maintained their newly acquired responsibility and the grant more or less kept pace with rates of inflation. The following table (Figure 2.1) gives an indication of the permitted rate poundage increase between 1978 and 1982:

Figure 2.1

Year	Permitted Rate Increase
1978	11%
1979	10%
1980	10%
1981	12%
1982	15%

Source: The Financing of Local Authorities, NESc, 1985 p. 28

Between 1978 and 1982, the growth in rateable valuations on average was 3% and when combined with the permitted increases set down by central government, this meant that the grant in lieu of domestic rates rose by 98 per cent, which almost matched the inflation level of 103 per cent over the same period. Therefore, in real terms, local authority

⁷ KPMG Consultancy, *The Financing of Local Government in Ireland*, (Dublin 1996) p. 18

incomes fell by only 5 per cent.⁸ Analysis of these figures would certainly suggest that the introduction of a centrally funded grant system as a credible alternative to domestic rates did in fact work in the beginning and local authority finances remained relatively stable in the immediate years after 1978.

Service Charges

Although the Government did attempt to compensate local authorities for the loss of domestic rates after the introduction of the 1978 Act, it was obvious that such a commitment was going to exert a considerable strain on the central government coffers. As a result, the Government sought to introduce alternative sources of revenue for local authorities. The Local Government (Financial Provisions) (No. 2) Act, 1983, was implemented to provide local authorities with additional outlets to generate revenue for themselves. The two key provisions of this act were as follows: first, the Minister for the Environment was no longer required to meet in full the amount of income lost from domestic rates and secondly, local authorities were given the power to charge for the various services they provided including domestic water, sewerage and refuse charges. Although this practice was not new to rural authority customers,⁹ those residing in urban councils were not accustomed to paying for such services and were resolute in their opposition to such charges. As a result, the extra revenue which the government had anticipated from the introduction of these charges was not realised. The government had assessed the public mood accurately when they removed domestic rates; however, they had misjudged public opinion when it came to the introduction of service charges. The public perception was that these charges were in effect an additional tax which they should not be liable to pay. An increase in income tax had already coincided with the removal of domestic rates with the result that most people saw these charges as a double taxation. In the face of such fervent opposition, the attempt to introduce service charges was always likely to fail politically. It is not surprising therefore, that around this time, the government began to reduce the level of grant payments in lieu of domestic rates owed to local authorities. Up until 1982 these grants were more-or-less keeping pace with

⁸KPMG, (1996) p. 18

⁹The Sanitary Services Act, 1962, empowered County Councils to charge for the supply of water to households.

inflation but by 1983 the cap on rate poundage increases was no longer matching inflation levels. As a result, a significant shortfall was beginning to occur in the Exchequer contribution compared to what local authorities would have yielded through domestic rates.

The situation was further compounded in 1982 by a High Court ruling that the basis for agricultural rates was unconstitutional and two years later this decision was upheld in the Supreme Court. With the loss of agricultural rates, local authority finances suffered again. Although the government proposed a grant system to make up for the shortfall, this grant in lieu of rates on land failed to fully compensate local authorities for the loss of agricultural rates. Local authorities had encountered a second serious blow in terms of their revenue making capabilities.

Thus, by the mid 1980s, the structure of local authority financing had been fundamentally altered. Local authorities could no longer rely on domestic and agricultural rates as chief independent sources of revenue, which could be increased accordingly given the financial demands of the services required. These two developments, each viewed in an isolated context, although proving problematic for local authority finances were difficulties which could be overcome. However, when taken together, the loss of domestic and agricultural rates coupled with an increasingly ineffectual central grant relief system meant that local authority financing was facing an uphill struggle. Moreover, the reactive policy of introducing service charges in an attempt to boost Exchequer funding had not yielded the anticipated revenue for local authorities but instead had galvanized public opinion against the implementation of any service charges. Thus, by 1983, Ireland had one of the lowest levels of local taxes (rates) and was second highest to the Netherlands in terms of dependence on central grants compared to other EC Member States.

Reports

A report entitled 'The Financing of Local Authorities' published by the National Economic and Social Council (NESC) in 1985 was highly critical of the central nature of the funding system in place for local authorities stating that the financial arrangements for local authorities owed 'much to past expediency but little to reason'.¹⁰ It examined alternative sources of local funding and suggested that more discretion should be given to local authorities regarding expenditure and supported a charge relating to services as well as a 'property tax based on capital values'. This latter method would ensure local accountability and provide local authorities with a 'predictable and variable source of finance' as well as widening the national tax base.¹¹ The NESC Report concluded that the financing of local government stood at a 'watershed' and 'without change there is likely to be further escalation of what are already serious financing difficulties'.¹²

The Commission of Taxation also reviewed the financing of local government in 1985 commenting on the need for independent sources of income to be generated locally. It also commented on the need to distinguish between the services provided by local authorities as either local or national and concluded that national services should be financed from central taxation through government grants. Yet, despite the recommendations and findings contained in these two reports, no change or reform resulted. Instead, the financial makeup of local authorities was to follow a similar pattern with central funding continuing to account for the majority of local government funding.¹³

¹⁰ National Economic and Social Council, NESC Report No. 80 *The Financing of Local Authorities*, p. 19 (Dublin 1985)

¹¹ *Ibid.* p. 8

¹² *Ibid.* p. 21

¹³ Analysis of figures in the Returns of Local Taxation reveal that in 1987 Government Grants still made up a sizeable proportion of local authority revenues providing as they did 60.9 per cent of income with Rates amounting to 13.5 per cent while Charges and Fees accounted for the remaining 25.6 per cent. Central funding would however, continue to decrease as a result of the ending of central government subsidies to meet local authority loan repayments. Accordingly, a series of deductions were made from the Rate Support Grant to counterbalance the removal of the liability of these repayments and other expenditure items. By the mid 1990s, central funding would level off to around forty per cent of local government revenue sources. See Coughlan and de Buitleir, p. 19

In the mid 1990's KPMG were given the task of exploring the existing and future expenditure requirements of local authorities as well as identifying a comprehensive range of options for developing a fair, equitable and reasonable system of local government funding. In addition, the study was to identify future funding options that would yield the most positive results.¹⁴ The Consultancy firm KPMG was given the task of preparing this study and the resulting report, 'The Financing of Local Government in Ireland' was published in June 1996. The significance of this report has been somewhat overlooked especially as it appeared in the same year as 'Better Local Government – A Programme for Change'.

The KPMG report found that the system of financing local government was 'highly centralised' especially in the aftermath of the transfer of domestic rate payments in 1978. It stated that although local government has been increasingly financed by local sources, the current system was widely regarded as inflexible and this was particularly the case with regards to the limited discretion given to local authorities in determining local service levels and related expenditure levels. In addition, the system which was in place offered limited discretion to local authorities which in turn offered little buoyancy. The fact that 'Ireland has tended to confine the financing of local government to very narrow bases of property taxes, central grants and charges for services' was criticised. Moreover, the need for an 'equalisation' role by central government in providing financing to local authorities with narrow funding bases and higher expenditure requirements than other local authorities was also mooted. The implementation of a Needs and Resources model seems to have subsequently satisfied this recommendation. Like its predecessors findings, this report favoured the introduction of a local property tax, which it stated would be a) easy to administer; b) provide potential to raise substantial revenues; and c) was found to be equitable. However, the report was also aware of the potential political repercussions from the public should such a tax be introduced. The report also stated that there was 'scope to raise additional revenues from local authority charges' and with reference perhaps to the ill fated attempt at introducing service charges in the 1980s, the report

¹⁴ See the Executive Summary of KPMG's report, *The Financing of Local Government in Ireland*, (1996) p. 1)

commented on the merits of service charges stating that ‘charges can provide a clear link to consumption of a service; are transparent; [and] can be used to encourage conservation and can be linked to national environmental policy’.¹⁵

If nothing else, this report was important as it detailed the deficiencies which were at the heart of local government financing. Despite offering an incisive study of the needs and future financial requirements for local authorities, its recommendations and findings were somewhat ignored in the immediate aftermath of its publication. Although some recommendations did gain credence in subsequent Local Government Acts (proposals on the equalisation of central funding and the need for buoyancy in revenue sources), central government were resolute in adhering to its own agenda with the result that water and sewerage charges were abolished in 1997, something which ran counter to the ethos of the report compiled by KMPG. Indeed some of the recommendations contained in BLG went against those of the KMPG report and these are considered below.

‘Better Local Government – A Programme for Change’ (BLG), which was published in 1996 by the Department of the Environment, was founded around four core principals: enhancing local democracy, serving the customer better, developing efficiency and most importantly where this paper is concerned, providing proper resources for local authorities. This latter point in particular was problematic for local authorities and the *Introduction* of BLG comments that the ‘system has been inhibited by a shortage of resources and an over-dependence on central Government decisions which are made annually as part of the budgetary process’. Funding difficulties had thus hampered the work of local authorities in taking on ‘relatively small capital projects without special outside funds’ and in responding ‘with financial support to worthwhile community initiatives’.¹⁶ BLG sought to remedy the funding situation through the ‘introduction of a source of revenue with in-built buoyancy and a measure of local discretion’¹⁷ It continued: ‘new sources of funding are urgently required by the local authority system, but there is a general political and community agreement that the provision of new

¹⁵ Executive Summary of KPMG’s report, *The Financing of Local Government in Ireland*, p. 7

¹⁶ *Better Local Government – A Programme for Change*, Introduction, (Dublin 1996)

¹⁷ *Ibid.*

funding should not involve an increase in the overall burden of taxation'.¹⁸ On the basis of this statement, it appeared that the avenue open to the funding problem was the extension of service charges or perhaps the consolidation and revitalisation of existing financing practices. However, the protagonists behind BLG had other ideas. Instead they sought to abolish water and sewerage charges where they existed, assimilating such charges into the remit of 'general taxation'. The argument here was that it was difficult to charge for such services on the basis of usage. Moreover, it was hoped that the abolition of such charges would result in cost savings to local authorities as the potential administrative, legal and other costs would no longer be applicable.

A somewhat unexpected source was chosen to become the basis of the new funding system. In order to replace the Rate Support Grant (RSG) and the revenues lost from domestic water and sewerage facilities, it was decided that the full proceeds of motor taxation would become a dedicated local government revenue source. This new scheme was to be accompanied with a variation element, which would allow some local authorities to vary the motor tax cost thus increasing the potential revenue yield if required. Moreover, it was hoped that this method of funding would provide for a certain level of buoyancy in future years. In addition to this new system, an equalisation fund was to be established. This would support the less well-off authorities in ensuring that they too would be able to provide services at an acceptable level.

Response and reaction to the new funding system was mixed. On the one hand, the net proceeds from Motor Tax collection eclipsed the combined total of revenue from domestic water and sewerage charges and the rate support grant together. Moreover, in 1997 it provided an extra €48 million for local authorities compared to 1996. This new system also tried to incorporate an element of equalisation. However, aspects of BLG seemed to be the antitheses of many of its predecessor's findings and recommendations certainly in terms of abolishing some charges and Dollard rightly asserts that the abolition of such charges was seen as a 'retrograde step', thus reducing local discretion,

¹⁸ *Better Local Government – A Programme for Change*, Introduction, (Dublin 1996) 5.3

accountability and decision making.¹⁹ For all the supposed merits of linking usage with payment, this concept was ignored. Moreover, the notion that rates of motor tax would differ in the various local authorities proved short-lived and the idea was abandoned.

These proposals were eventually enacted in the Local Government (Financial Provisions) Act, 1997. Shortly after, the 'Rainbow Coalition' government of Fine Gael, Labour and Democratic Left was replaced by a Fianna Fail and Progressive Democrat government who generally accepted their predecessors' proposals with some changes relating to local government financing. However, before the budding system could take root, the new system which had been promulgated in Better Local Government, was terminated with effect from 31 December 1998. The Local Government Act, 1998 provided for a new financial system to be introduced on 1st January 1999.

One of the main features of this new system was the creation of a Local Government Fund which was to replace the local government equalisation fund. It was to be funded through a combination of sources: an exchequer contribution (€343 million in 1999) and the net proceeds of Motor Tax. The initial exchequer contribution was to be ring fenced and specified in legislation. The exchequer contribution was to be index linked each year at least in line with inflation and was also to make provision for the additional expenditure needs of local authorities.

The new funding system was finally to incorporate a recommendation which several reports had made, the idea of equity distribution as part of central funding in an equitable manner. Galway County Council was used as a pilot study in an attempt to devise a system, which would result in the distribution of the general purpose block grant in an equitable manner. What resulted was the 'Needs and Resources Model' that was designed to implement a programme of equalisation and to encourage efficiency in the allocation of such grants. The current system relies on the computer-based Needs and Resources Model which 'makes an assessment of how much each local authority should spend on each service/activity (needs) and the income (resources) each authority should generate

¹⁹ Dollard, (2003) p. 337

from these services/activities’.²⁰ Income from these services or activities is derived from an array of sources including rates, charges, fees and rents. This model has been in place since 2000.

In 2004, a major review of Local Government Financing was commissioned by the Minister for the Environment, Heritage and Local Government which was to focus on local authority current expenditure. When the Minister, Dick Roche, eventually published the report²¹ on 1st March 2006, he stated that it contained ‘much useful analysis which will inform policy on local government financing, and on efficiency and value for money in the local government sector, into the future’.²² The main recommendations contained in the report highlighted the need for more locally based sources of funding including the extension of water charges, the introduction of a new tax on non-principal private residences, the need to ensure economic charging for local authority services generally, an increase in current charges and a contribution from commercial properties not currently covered by commercial rates. By looking at financing in an international context, it highlighted the link between local accountability and the ability of local authorities to generate funding which existed in other countries. Like ‘The Financing of Local Government in Ireland’ Report before it, the ‘Review of Local Government Financing’ highlighted the fact a shortfall in revenues and expenditures would result in the coming years and that this ‘funding gap will have to be addressed by a combination of efficiencies, increases in charges, commercial rates or motor taxation, new sources of local revenues or increases in exchequer funds or a reduction in services’.²³

Although commenting on the merits of the report by Indecon Economic Consultants, the Minister stated that some of ‘the revenue generating options identified by the consultants run counter to current Government policy’. He continued: ‘the Government, therefore,

²⁰ Local Authority Budgets 2004, p. 10

²¹ The Report was compiled by Indecon Economic Consultants and the Institute of Local Government Studies at the University of Birmingham.

²² Press Release from the Department of the Environment, Heritage and Local Government 1/03/06

²³ Indecon, (2006) p. iv

does not support the recommendations to introduce domestic water charges or to impose a new tax on non-principal private residences'.²⁴

Thus, with his latter statement, the Minister negated his previous comment on the potential value and worth of the Report. In a sense, the Minister's reaction was no great surprise. Indeed, it was symptomatic of, and follows a trend of governmental response and reaction to reports of this kind which challenge the central nature of local authority financing and which attempt to identify alternative sources of funding for local authorities. Despite acknowledging the report's recommendations in terms of expenditure requirements in the immediate future and accepting that local authorities must be adequately resourced in order to continue to deliver infrastructure, services and facilities for the communities they serve, the Minister seemed more intent on stressing the need for value for money, and encouraging the need for efficiency rather than extending the revenue generating capacities of local authorities.

Conclusion

While the report compiled by Indecon Economic Consultants echoed many of the recommendations put forward by KPMG Consultancy ten years earlier, all of the reports published since 1978, have tried to emphasis the need for independent sources of revenue to be generated locally. Moreover, they have been highly critical of the central nature of local authority funding. These reports, with the exception perhaps of the Barrington Report, have not called for extra powers or functions to be granted to local government. Instead they have tried to impress on central government the need to devolve some revenue generating outlets in order to ease funding problems for local authorities. Yet rather than embracing the funding issue head on, successive governments have refused to acknowledge the chronic shortage of locally available sources of funding and in some cases, their actions including the abolition of water and waste charges in 1997, have run counter to recommendations contained in these reports, further eroding any remaining local sources of revenue.

²⁴ DOEHLG Press Release 1/03/06

Although urban authorities have the benefit of charging commercial rates on businesses thus increasing their revenue base, rural authorities are restricted by the lack of a plentiful supply of commercial enterprises under their jurisdiction. Therefore, the introduction of domestic water charges or taxes on second homes; the majority of which are in rural parts of the country, would certainly offer these authorities a greater revenue generating base. Yet, central government perhaps fearing the potential political consequences of such acts, refuse to provide local government with more outlets to raise funding locally with the result that as costs continue to rise, local authorities will be increasingly dealing with shortfalls thus preventing them to balance their annual budgets in the future and in providing adequate levels of service to the public.