

PO-CH / NL / 0251

PART E

Part E.

**SECRET**

(Circulate under cover and notify REGISTRY of movement)

Begins: 11/4/88.  
Ends: 12/5/88.



PO -CH /NL/0251



PART E

Chancellor's (Lawson) Papers:

THE COMMUNITY CHARGE AND  
SETTLEMENT OF THE RATE  
SUPPORT GRANT SYSTEM

Disposal Directions: 25 years

27/9/95.

PO -CH /NL/0251  
PART E

CONFIDENTIAL



FROM: MISS M P WALLACE

DATE: 11 April 1988

*BF 18/4*

MR CULPIN \*

cc PS/Chief Secretary  
Sir P Middleton\*  
Mr Anson  
Mr Phillips  
Mr Byatt  
Mr Hawtin  
Miss Peirson  
Mr Turnbull  
Mr Riley\*  
Mr McIntyre  
Miss Sinclair\*  
Mr Tyrie  
Mr Call

\*With recent papers

**HOUSING BENEFIT AND UNEMPLOYMENT/POVERTY TRAPS**

The Chancellor has seen the most recent papers on this (copies attached for you and others not on previous circulation), including Lord Young's letter of 31 March to Sir Henry Phillips, in which he expresses enthusiasm for the idea of setting up a task force to look at 'the extent to which the combination of tax, national insurance and benefit rules can act as a disincentive to employment and growth'. The Chancellor would be grateful if you, in consultation with ST and others, could produce a quick and fairly brief paper for the Chancellor to send to Lord Young and Mr Ridley, making the point that this is a benefit and not a tax/NIC problem, and that it is an inescapable consequence of targeting benefit on the neediest.

*M.P.W.*

MOIRA WALLACE

The Rt. Hon. Lord Young of Graffham  
Secretary of State for Trade and Industry

Miss Deborah Lamb  
Private Secretary to the  
Secretary of State for the  
Environment  
Department of the Environment  
2 Marsham Street  
LONDON SW1P 3EB

EXCISE	
05 APR 1988	
CST	
MR ANGON	
10	MR H PHILLIPS Tlx
	MR HANTIN Fax
	MISS PEIRSON
	MR TURNBULL
	MR MCINTYRE
	MR CALL

Department of  
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Our ref DW3DPO  
Your ref  
Date 31 March 1988

Sr P Middleton  
Mr Byatt  
Mr Culpin

*Dear Deborah*

**POVERTY TRAP: LETTER FROM SIR HENRY PHILLIPS**

I attach a copy of a letter my Secretary of State received recently from Sir Henry Phillips about the cumulative effects of fiscal and social security policies.

Given the current correspondence about the issue, the Secretary of State thought Mr Ridley and other colleagues might be interested to see the letter. A copy of the Secretary of State's reply is also attached.

I am copying this letter and the attachments to Paul Gray, Alex Allen (HMT), Geoffrey Podger (DHSS), Margaret Jones (Scottish Office), Jon Shortridge (Welsh Office), Nick Wilson (Employment) and Trevor Woolley (Cabinet Office).

*Yours*

*Jeremy Godfrey*

JEREMY GODFREY  
Private Secretary

**dti**

the department for Enterprise

The Rt. Hon. Lord Young of Graffham  
Secretary of State for Trade and Industry

Sir Henry Phillips  
34 Ross Court  
Putney Hill  
LONDON  
SW15 3NZ

CH/EXCHEQUER	
NO	05 APR 1988

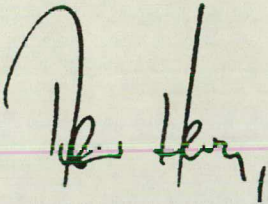
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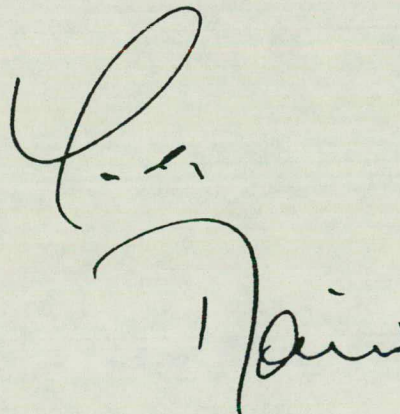
Telex 8811074/5 DTHQ G  
Fax 01-222 2629

Direct line 215 5422  
Our ref DW3DPR  
Your ref  
Date 31 March 1988

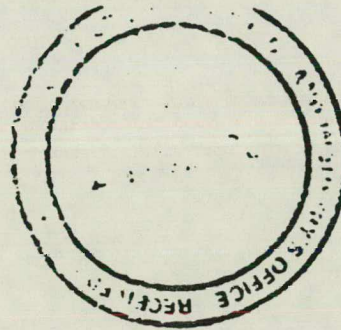


Thank you for your letter of 23 March setting out your concerns about the cumulative effects of fiscal and social security policies. This is a subject in which I take a close personal interest, not least because of the extent to which the combination of tax, national insurance and benefit rules can act as a disincentive to employment and growth - to the detriment of the individual and the economy generally.

We all want to get rid of the poverty trap but, as you say, it is an especially difficult problem to get to grips with. That said, the approach you suggest seems worth consideration and I will certainly pass copies of your letter on to those of my colleagues directly concerned.



SIR HENRY PHILLIPS



34 ROSS COURT  
PUTNEY HILL  
LONDON SW15 3NZ  
01-788 1404

23 March 1988

The Rt Hon Lord Young of Graffham

*Dear David,*

It gave us great pleasure to listen to you last night, so relaxed, so confident and so optimistic; and you fielded the questions with a fine combination of skill and wit. The part you have played in the turn round of the economy is a matter for warm congratulation.

I do have a concern which I might have voiced, but it would have been difficult to compress it into a short question; so I am writing to you instead.

While countless people are set to benefit in one way or another from the recent Budget and from the impending reforms in local taxation and social benefit, there still remains a sizeable number who do not benefit, and some will lose. There is moreover a tendency for the same people to be affected in different ways.

The impact of the proposed community charge and of the interim obligation to pay 20% of the general rate, the changes in housing benefit (which are of particular concern to the Housing Association movement), the new fiscal treatment proposed for one-parent families, the alleged lack of Government support for child care which inhibits the mother in her search for remunerative employment - all these examples, and there are others, tend to affect the same disadvantaged section of the population who, not surprisingly, become vocal and claim the attention of the media.

The problem is compounded by the reliance of the Government, in endeavouring to measure the effect of its reforms, on national averages. Regrettably there are regional and neighborhood averages which are substantially lower; and this distorts the picture.

A further difficulty is that several Government departments are involved in dealing with matters of hardship in

their respective spheres of responsibility with the result that the Government may be deprived of essential advice on the collective effect of the measures it is introducing.

Is there perhaps a need to assign to a small task force of civil servants the job of collating information about these changes, measuring their combined effect on various classes of people and, where necessary, proposing ways of alleviating hardship in cases where the new income support regulations do not go far enough? So that such a body was not overwhelmed by a flood of individual complaints it would deal only with representative bodies such as Age Concern, the National Federation of Housing Associations, the Maternity Alliance and the Child Poverty Action Group through which individuals would be advised, by printed circular, to channel their complaints.

All these organisations are of course awash with details of potential hardship within their respective spheres of influence and will have made representations to the concerned Government departments. It is the cumulative effect which worries me and which has inspired this letter.

The Tory Party wants to be known as a caring party; but I do feel that it is running a risk of not earning this description as far as low income families are concerned. Maybe what I am suggesting could help. Because the suggestion implies an overview there is no one Minister to whom I can address it. If therefore you think that it merits examination may I leave it to you to put it into the right channels?

With all good wishes

Yours ever  
Henry

**CONFIDENTIAL**

The Rt. Hon. Lord Young of Graffham  
Secretary of State for Trade and Industry

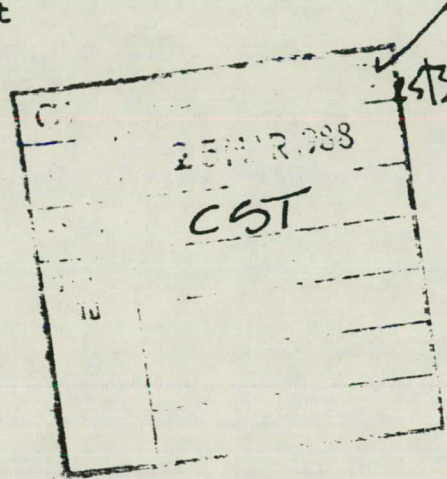
Deborah Lamb  
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Direct line 215 5422  
Our ref PS4AKC  
Your ref  
Date 24 March 1988

*Dear Deborah*

#### EMPLOYMENT TRAP OF HOUSING BENEFIT POLICIES

Thank you for sending us a copy of your letter of 4 March to Paul Gray about the planned review by officials of options for alleviating the unemployment/poverty trap. We have also seen the letters dated 8 and 9 March from Jill Rutter and Rod Clark respectively.

This is a subject in which my Secretary of State and the Chancellor of the Duchy of Lancaster both take a close personal interest. The Secretary of State has been concerned for some time about the extent to which the UK's tax, national insurance and benefit systems may act as a disincentive to employment and growth - to the detriment of the economy generally.

My Secretary of State considers that this is an area which needs to be looked at in its entirety and therefore supports your Secretary of State's proposals for a Working Group of officials with the wider remit described in your letter of 4 March. He would wish this Department to be represented on any such Group.

I am copying this letter to Paul Gray, Alex Allan (HMT), Geoffrey Podger (DHSS), Margaret Jones (Scottish Office), Jon Shortridge (Welsh Office), Nick Wilson (Employment) and Trevor Woolley (Cabinet Office).

*Yours*

*Jeremy Godfrey*

JEREMY GODFREY  
Private Secretary





Paul Gray Esq  
 Private Secretary to  
 The Prime Minister  
 10 Downing Street  
 LONDON  
 SW1A 2AA

CHIEF SECRETARY	
REC.	24 MAR 1988
ACTION	Mr McIntyre
COPIES TO	Mr. Busca, Mr Phillips
	Mr. Hutton, Miss Pearson
	Mr. Turnbull, Mr. G. G. G.
	Mr. Call

8 MARSHAM STREET  
 LONDON SW1P 3EB  
 01-212 3434

My ref:

Your ref:

23 March 1988

Dear Paul,

Thank you for your letter of 17 March which my Secretary of State saw with those from Jill Rutter of 8 March and Rod Clark of 9 March.

My Secretary of State is happy for the work to be carried forward in the DHSS group to a remit broadly as proposed by the Chief Secretary. He remains convinced that the problems raised in his minute of 19 February are real ones and must be addressed urgently: in his view, the marginal tax rate illustrated in that minute of 90.1% for low earners is already excessive, particularly after the income tax reductions in the Budget; and it would now be all the more unwise to increase that tax rate to 93.4% by steepening the housing benefit taper to 70% for 1989/90. He is coming under increasing pressure in the Local Government Finance Bill where the issue is beginning to be understood by a number of backbenchers. He fears the subject will be difficult to handle at Report Stage, and even more so when the Bill is in the Lords. It may also arise on the Housing Bill.

Accordingly, my Secretary of State hopes that the group can consider the options quickly, to a timetable which would allow for collective Ministerial discussion before, say, the end of May, in advance of the main PES discussions. Perhaps Geoffrey Podger could confirm that such a timetable is achievable.

I am copying this letter to Jill Rutter (Treasury), Geoffrey Podger (DHSS), Margaret Jones (Scottish Office), Jon Shortridge (Welsh Office), Alison Brimelow (DTI), Nick Wilson (Employment) and Trevor Woolley in Sir Robin Butler's Office.

Yours sincerely,  
 Deborah.

DEBORAH LAMB  
 Private Secretary



10 DOWNING STREET  
LONDON SW1A 2AA

REC.	18 MAR 1988
TO	Mr McIntyre
	Cx, Mr Anderson, Mr Phillip
	Mr Newton, Miss Pearson
	Mr Turnbull, Mr Gibson
	Mr Call

From the Private Secretary

17 March 1988

Dear Deborah,

EMPLOYMENT TRAP OF HOUSING POLICIES

Thank you for your letter of 4 March which the Prime Minister has seen. She has also now had an opportunity to consider all the further exchanges following my letter to Roger Bright of 22 February.

The Prime Minister considers the mechanics for carrying forward the further work by officials would best be handled through the inter-Departmental group already set up under DHSS chairmanship, and she would wish the Policy Unit to be involved in its further work.

The Prime Minister does not wish to suggest precise terms of reference for the group but does not think it appropriate for the remit to extend to a general consideration of options for alleviating the unemployment and poverty traps. The work should be more narrowly focused along the lines suggested by the Secretary of State for Social Services and the Chief Secretary.

She hopes that the work could focus mainly on options which do not involve increased expenditure or numbers of housing benefit recipients; attention might also be given in appraising the options to net income after housing costs as well as housing costs as a percentage of net income.

The Prime Minister also feels that the conclusions of the work by officials should be fed into the public expenditure survey in the normal way, with the appropriate Secretaries of State taking responsibility for their expenditure programmes.

I am copying this letter to Jill Rutter (Treasury), Robin Weatherson (Scottish Office), Jon Shortridge (Welsh Office), Alison Brimelow (Department of Trade and Industry), Nick Wilson (Department of Employment), and Trevor Woolley (Cabinet Office).

Yours,  
Paul.

PAUL GRAY

Miss Deborah Lamb,  
Department of the Environment.

CONFIDENTIAL

1 copy sent  
to P Mc Intyre.  
CST to circulate  
rest.

SECRET



10 DOWNING STREET  
LONDON SW1A 2AA

CH/EXCHEQUER	
REC.	12 APR 1988 ✓ 12/4
ACTION	CST
COPIES TO	

From the Private Secretary

11 April 1988

*any BF 15/4*

### COMMUNITY CHARGE REBATES

The Prime Minister held a meeting this afternoon to discuss community charge rebates. Those present were the Chancellor of the Exchequer, your Secretary of State, the Lord President and the Chief Whip. The meeting considered your Secretary of State's letter of 7 April about the Mates amendment and the Chancellor's reply of 11 April.

Your Secretary of State said he had concluded that some change to the rebate arrangements should be introduced. The Mates amendment had become the focus for concern amongst back-benchers about the combined impact of the various changes being introduced via the social security reforms and the introduction of the community charge. But the Mates amendment was badly targeted on low income earners, and your Secretary of State had put forward the alternative package in his letter of 7 April of a reduction in the slope of the community charge rebate taper from 20p to 15p, and a £10 increase in the earnings disregard.

In discussion the following main points were raised:

- (i) Any increase in the earnings disregard would have a major read-across to and adverse repercussions for the social security changes. Considerable credit had been taken for the proposed simplification whereby a common earnings disregard would apply for different benefits. Now to change the disregard for the community charge would create strong pressures to raise the disregard for the rent element of housing benefit and for income support. The same objection did not however apply to the proposal to modify the slope of the community charge rebate taper.
- (ii) Officials were still discussing the precise costs of the proposed change in the slope of the taper to 15p in the pound. In public expenditure terms there would however be a nil cost if a small amount was added to all community charge bills to finance additional rebates for the less well off.

SECRET

- (iii) It had now emerged that the Mates amendment as presently drafted would not be in order; because of the substantial extra work implied for the Inland Revenue it required a Ways and Means Resolution. It was understood that Mr. Mates was considering ways out of this difficulty, for example by placing the responsibility for assessing information about community charge payers' incomes on local authorities rather than the Inland Revenue.
- (iv) Further consideration was being given in a group of officials chaired by the DHSS to the implications of the decision taken in the 1987 Public Expenditure Survey to raise the housing benefit rent taper from 65 per cent to 70 per cent in 1989-90. The results of that work, which would involve looking at other options for yielding comparable housing benefit savings, would be for separate Ministerial consideration at a later date.
- (v) Careful thought would need to be given to the timing of any announcement of a change to the proposed community charge rebates. It would be desirable to avoid giving precise details until the debate on 18 April; and this would be possible because any change to the rebate taper would be implemented via regulations rather than requiring any amendment to the Bill. But it would be desirable, possibly on 14 April, to give some indication to back-benchers that a change to the rebate arrangements would be made.
- (vi) Careful attention should also be given to the presentation of the terms of any change to rebates. This would need to be put in positive terms and in easily comprehensible layman's language.
- (vii) Any change to the community charge rebates would not apply to the rebate arrangements for local authority rates during the period prior to the introduction of the community charge. Careful consideration needed however to be given to whether any change to the community charge rebate system planned for England and Wales from 1990-91 should be introduced on the same date in Scotland or with effect from 1989-90 when the Scottish community charge regime started. The Department of Health and Social Security and the Welsh Office also would need to be involved in discussions of any changes to the community charge rebate arrangements.

Summing up the discussion the Prime Minister said that it was agreed that there should be no increase in the earnings disregard for the community charge. Some concession would however be appropriate in the slope of the community charge rebate taper, with an amount being added to all community charge bills to finance additional rebates for the less well off. Your Secretary of State and the Chief Secretary should

consider further a range of options for changes to the taper. They should also arrange for the Scottish Office to be consulted, in particular about the implementation date for any change in Scotland, and also for discussion with the Department of Health and Social Security and the Welsh Office. Your Secretary of State should also give further thought to the presentation of the proposed revised rebate taper arrangements that resulted from these further discussions. No indication of the possibility of a change to the rebate arrangements should be given before Thursday 14 April; and precise details should not be given before the debate on Monday 18 April. Meantime your Secretary of State would advise on the line the Prime Minister might take if this subject was raised at Question Time on Tuesday 12 April.

I am sending copies of this letter to Alex Allan (H.M. Treasury), Alison Smith (Lord President's Office) and Murdo Maclean (Chief Whip's Office).

PAUL GRAY

Roger Bright, Esq.,  
Department of the Environment.

FROM: J P MCINTYRE  
DATE: 11 April 1988

CHANCELLOR

cc Chief Secretary  
Mr Phillips  
Mr Potter

**COMMUNITY CHARGE REBATES**

You asked for a note on the price we would want to extract, on the social security programme, for agreeing a cut in the community charge rebate taper from 20 per cent to 15 per cent.

2. The two elements in this, agreed by you and the Chief Secretary, are:

i. Rents taper

You will want confirmation of last year's E(LF) agreement that the income taper for rent assistance will rise from 65 per cent this year to 70 per cent in April 1989. Mr Ridley must agree to drop his opposition to this. Without the increase, Housing Benefit (HB) expenditure would increase by £50 million a year, and a further 60,000 people would become entitled to help with their rents, on top of the 4½ million already entitled.

ii. Measures to curb HB expenditure

You will want to seek agreement that measures to curb HB expenditure should be looked at by Mr Moore and the Chief Secretary in this year's Survey, including:

a cap on HB entitlement; and

a cut in the 97% subsidy paid to Local Authorities on Housing Benefit payments.

3. A cap on HB entitlement might need to be varied according to area and family size. But it would be well worth establishing whether it would be feasible. The new rule that those on HB get 100 per cent compensation for rent increases, without limit, is not conducive to controlling expenditure. A lower rate of subsidy to LAs would give them a stronger incentive to operate the system economically and look for fraud.

4. You might also make the point that the concession on the community charge rebate taper might make it easier to resist other easements in the new HB regime, such as pressure for an increase in the £6,000 capital rule.

5. In making these points, you will no doubt have in mind Mr Moore's responsibility for HB. As you know, he and Mr Ridley are considering a joint approach to the PM proposing the transfer of HB to DOE (and the territorials). We have so far resisted this. As an alternative, Mr Ridley has also been angling for a greater say on HB in the Survey, which we have also been resisting. For these reasons, the proposals for further measures to curb HB expenditure should be taken forward in the Survey, for discussion between Mr Moore and the Chief Secretary. It would be for Mr Ridley to make any points to Mr Moore about the implications for housing policy.

*JM*

J P MCINTYRE

*You made the opposite point in your letter!*

11/4/88



Chief Secretary,

The attached draft  
is what the Chancellor  
is minded - subject to  
your comments - to  
send to Mr Ridley first  
thing on Monday morning

Alex Allan



## PERSONAL AND CONFIDENTIAL



FROM: CHIEF SECRETARY

DATE: 11 April 1988

CHANCELLOR

## COMMUNITY CHARGE REBATES

I have looked carefully at Mr Ridley's letter, Mr McIntyre's submission of 8 April and your proposed letter to Nick. There are many facets to this problem and several points occur to me.

2 Firstly, perception. This is a major retreat. It will be seen as an acknowledgement that we had been too tough on the poor in the social security reforms and have to retreat on the Community Charge.

3 Moreover, the retreat is on Housing Benefit, the weakest point with our backbenchers. It will add to pressure on the capital cut-off specifically and the social security reforms generally.

4 All this will whet DHSS's appetite for the PES round.

5 Secondly, merits. The Chief Whip will advise but my guess is that Nick is right to be worried about Parliament. A concession therefore has political merits since it will, I think, purchase the Bill.

6 Moreover, if it does so at a cost to be clawed back from Revenue Support Grant it may prove a Treasury bargain. At present I fear that an un-amended Bill will leave us exposed in 1990 to a hugely swollen RSG to buy-off introductory problems.

PERSONAL AND CONFIDENTIAL

7 However, I do not see how we ensure the cost is recouped from RSG. We would need to square Cecil (as Chairman of E(LA) on this point.

8 Thirdly, Nick's proposals. They have the disadvantages set out in Mr McIntyre's minute. However, I accept a concession is necessary and is better made now.

9 I cannot see any novel way of meeting this problem other than those Nick sets out.

10 Of his two propositions, changing the Community Charge taper is much the best. If we increased the earnings disregard on Community Charge then:

- (a) ~~I do not see how we could avoid doing so for the rent element of Housing Benefit (which faces other pressures anyway);~~
- (b) we would face demands to raise it for all income related benefits;
- (c) it begins to unpick the 'simplification' case for the Social Security reforms.

This is too high a price.

11 We should therefore restrict any concession to the tapers. I do not share Mr McIntyre's sensitivity about the 20 per cent rate taper at present and only 15 per cent for Community Charge. This is easily defended (though who will attack it anyway?)

12 Fourthly, our price for the concession. I agree we should seek to recoup through RSG though I cannot see how. Perhaps Cabinet should minute it? However, we can discuss means.

13 I agree too, we should insist that Nick accepts the PES agreement of a 70 per cent rent taper which, at present, he

PERSONAL AND CONFIDENTIAL

is seeking to over-turn.

14 I would suggest we also <sup>seek</sup> ~~meet~~ his agreement to:

(i) 'capping' a maximum Housing Benefit entitlement.

(ii) reducing the direct Housing Benefit subsidy to local authorities from its present 97 per cent ceiling.

(The Prime Minister should support both these objectives and it might be best to make these points verbally at the meeting).

15 Subject to these points, I am content with the substance of the proposed letter.



PP JOHN MAJOR

(Approved by the Chief Secretary  
and signed in his absence)



Treasury Chambers, Parliament Street, SW1P 3AG  
01-270 3000

11 April 1988

The Rt Hon Nicholas Ridley, AMICE MP  
Secretary of State  
Department of the Environment  
2 Marsham Street  
London SW1

cc- CST  
SIR P MIDDLETON  
MR H. PHILLIPS.  
MR MCINTYRE  
MR BAKER.

*Nicholas Ridley*

#### COMMUNITY CHARGE REBATES

Thank you for your letter of 7 April. As you know from our talk before Easter, I well understand the difficulties you are in as a result of Michael Mates' new clause. And I can see why you are attracted by the idea of announcing concessions at Report Stage. But the proposals in your letter do raise considerable difficulties. In particular, they are considerably more expensive than you indicated when we spoke, and they would conflict with our policies of reducing dependence on benefits; they would also weaken accountability.

They would, as you say, cost around £200 million. This would be over and above the £400 million or so we will already be providing through Income Support in compensation for those on benefit who will have to pay 20 per cent of the community charge. It would also be additional to the £1½ billion or more we are likely to spend on the rebate scheme as it stands.

Your proposals will also, as you acknowledged, bring a further 1¼ million individuals and couples within the rebate scheme. This would be on top on the 7 million or so who are currently expected to be entitled to rebates. The proposal would therefore be a major reverse for our policy for reducing dependence on benefits.

A further consideration we need to keep in mind is that your proposals will be seen not only in the context of the community charge but also of the social security reforms. There is a risk



that concessions here will be seen as an acknowledgement that we have been too tough on the poor in the social security reforms and have to retreat on the community charge. This will add to the pressure on us to make concessions elsewhere. And concessions on Housing Benefit will in particular add to the pressure on the capital cut-off.

The increase in the earnings disregard raises particularly difficult problems. It would remove one of the important simplifying features of the new social security system, since it would open up a gap again between the earnings disregard for different benefits. This would inevitably make it more complicated to administer, and would create strong pressures to raise the earnings disregard for the rent element of Housing Benefit and for Income Support as well.

The reduction in the community charge rebate taper also raises difficulties. But if, following our discussion with the Prime Minister and the Chief Whip later today, we are convinced that a concession is necessary, it is in this area I think a move might be least damaging. But I could only accept it on two conditions

- (i) that we stick firmly to our existing decision to raise the rent taper from 65 per cent to 70 per cent in 1989-90; and
- (ii) that we agree to recover the cost of the concession (about £130 million) from a commensurate reduction in the aggregate grant to local authorities in 1990-91. This is fully in the spirit of the Mates clause, since it means that a small amount is added to all community charge bills to finance additional rebates for the less well off.

With your agreement, I am copying this letter and yours to the Prime Minister.

A handwritten signature in black ink, appearing to read 'Nigel Lawson', written over a horizontal line.

**NIGEL LAWSON**



The Rt Hon Nigel Lawson Esq MP  
Chancellor of the Exchequer  
HM Treasury  
Parliament Street  
LONDON  
SW1P 3AG

7 April 1988

*Dear Nigel*

### COMMUNITY CHARGE REBATES

When we met before Easter we discussed the impact of the community charge on the less well off. We confirmed that, although Michael Mates' New Clause is nonsense in a large number of respects, nevertheless it has attracted a lot of sympathy from our supporters, probably on two counts: first, that it seemed to provide extra assistance to the less well off; and secondly, that it appeared to "clobber the rich" - at least a little.

On the impact on the less well off, there are a large number of our supporters both in and out of Parliament who share a vague perception that it is "unfair". I think they misdirect their criticism - it is not the community charge which causes this, but the combined effect of all the imposts which occur in moving from benefit to taxpayer levels of income. Nevertheless, our community charge proposals are a focus of this unease which presents itself to our supporters immediately. Also, it is one way of contributing to alleviating this unease to work on this part of the front, as well as facilitating the passage of the Bill.

The right answer to the Mates New Clause is to improve the rebate arrangements, so that they are seen to be "fairer" as well as taking out most of the beneficiaries of Michael's New Clause to the greatest extent possible.

In the wider employment trap context, a DHSS-chaired group of officials is, as you know, already looking at a number of options for improving the housing benefit arrangements. These include less steep tapers and increased earnings disregards, which would raise the level at which the taper starts for people in low-paid employment. The solution to the Mates problem lies, I believe, in making such adjustments to the community charge rebate scheme as well. But we cannot await the outcome of the DHSS Committee because Report on the Local Government Finance Bill is on 18 April; so I think we must proceed on community charge rebates in advance of whatever we decide to do on housing benefit generally.

I therefore propose that I should announce on Report a reduction in the slope of the community charge rebate taper from 20p to 15p, and a £10 increase in the earnings disregard (from £5 to £15 for single people and £10 to £20 for couples).

The cost of these two proposals together would be about £200 million (at 1988/89 prices) in 1990/91. They would mean that about 1½ million individuals and couples received rebates who would not otherwise do so. Of these about ½ million would be single people under retirement age, and about 300,000 would be single pensioners or pensioner couples. (The number of pensioners benefiting is limited because we are operating on earnings disregards - which do not disregard incomes from occupational pensions.)

I would like to have your reaction to these proposals as soon as possible - time is very short if we are to have something to announce at Report. Only a very small number of officials here are involved. If it would help for one of your officials to discuss the contents of this letter the person to contact here is John Adams (212 0961).

*John Adams*  
*John*

NICHOLAS RIDLEY

CONFIDENTIAL



1. ACSA  
2. mpw  
FROM: MISS M P WALLACE

DATE: 11 April 1988

PS/CHIEF SECRETARY

cc Sir P Middleton  
Mr Anson  
Mr H Phillips  
Mr Hawtin  
Mr Turnbull  
Mrs Case  
Miss Peirson  
Mr Gieve  
Mr Potter  
Mr Fellgett

**1989-90 RATE SUPPORT GRANT SETTLEMENT FOR ENGLAND**

The Chancellor has seen Mr Phillips' note of 8 April and Mr Fellgett's of 7 April to the Chief Secretary.

2. He feels that it is essential to be as tough as possible on provision. Even though, to a considerable extent, lower provision simply means a higher claim on the Reserve, it does have clear advantages: Mr Ridley will be reasonably sympathetic to squeezing provision; and lower provision means, for any given level of grant, a higher grant percentage, to which Mr Ridley attaches great importance.

*mpw.*

MOIRA WALLACE

MPW  
11/4



*papers psl BF18*  
*4*

*Alex*  
*we are trying*  
*to fix this for*  
*Fri 20/4 M*

From : D L C Peretz  
Date : 13 April 1988

PS/CHANCELLOR

cc PS/Sir P Middleton  
Mr Scholar  
Miss O'Mara

*psp*

PERETZ  
PS/CH  
13/4

**COMMUNITY CHARGE AND THE RPI : INDEXED GILTS**

You will remember that the Chancellor asked us to get urgent legal advice on this from the Law Officers (Mr Allan's minute of 7 April).

2. The Attorney General has now confirmed that he wishes Treasury Counsel (John Mummery) to be consulted first. We are putting this in hand, as quickly as possible (Miss Wheldon is drafting instructions).

3. Perhaps you could take an opportunity to mention this on the 'phone to Mr Allan in Washington.

*DLCP*

D L C PERETZ

BF 15/4



2 MARSHAM STREET  
LONDON SW1P 3EE  
01-212 3434

My ref:

Your ref:

Paul Gray Esq  
Private Secretary to  
The Prime Minister  
10 Downing Street  
LONDON  
SW1A 2AA

13 April 1988

**SECRET**

COMMUNITY CHARGE REBATES

Your letter of 11 April (not copied to all) set out the conclusions of a meeting held by the Prime Minister that afternoon at which Mr Mates' amendment to the Local Government Finance Bill was discussed, and it was agreed that an appropriate response would be a reduction in the slope of the community charge rebate taper.

Since that meeting DOE and Treasury officials have discussed further the cost of such a change and the options have been considered with the Chief Secretary; and the Department of Health and Social Security, the Scottish Office and the Welsh Office have been brought into the discussions. I am now writing to confirm the proposal that my Secretary of State, with the agreement of the Chief Secretary, wishes to make orally at Cabinet tomorrow.

My Secretary of State proposes that the community charge rebate taper should be 15p in the £, as compared with the 20p rate rebate taper which is in force in 1988/89. The reduced taper would come into effect in the year of introduction of the community charge - that is 1989/90 in Scotland and 1990/91 in England and Wales. The cost, in a full year, is estimated at £115 million to £130 million (GB figures at 1988/89 prices). This estimate is sensitive to assumptions about take up and the size of the community charge.

My Secretary of State agrees that the cost of reducing the taper from 20p to 15p should in this particular case be offset in the levels of Government grant to local authorities in the three countries in the relevant years. This means that a small amount will be added to all community charge bills to finance these additional rebates for the less well-off as agreed at the meeting. Obviously, however, the details of the figuring cannot be resolved now, as the relevant grant totals have not yet been set.

**SECRET - NO COPIES TO BE TAKEN**

In announcing what is proposed in the debate on Monday, my Secretary of State will explain that the effect of reducing the taper will be to extend the rebate system further up the income scale, so that about an additional 1 million community charge payers receive rebates who would not have done so with a 20p taper. Many of these are individuals who would have been helped by the Mates 50% band. So the Government has secured much of what the Mates amendment was seeking to achieve, but by a simpler and more appropriate route.

My Secretary of State agrees that it is essential that no indication of a possibility of a change should be given before the meeting with backbenchers tomorrow evening; and that precise details should not be given before the debate next Monday.

I am copying this letter to Alex Allan (Chancellor of the Exchequer's Office), Jill Rutter (Chief Secretary's Office), Alison Smith (Lord President's Office), Murdo Maclean (Chief Whip's Office), Geoffrey Podger (DHSS), David Crawley (Scottish Office), and Jon Shortridge (Welsh Office).

*Yours sincerely*  
*Roger Bright*

R BRIGHT  
Private Secretary

1

**SECRET**



BF 15/4

10 DOWNING STREET  
LONDON SW1A 2AA

From the Private Secretary

13 April 1988

*Handwritten notes:*  
D.P. 3591

At a meeting here on Tuesday your Minister developed a point that, even after the community charge has been introduced, the top ten per cent of householders will be paying substantially more towards the cost of local government than the bottom ten per cent of householders. He estimated the top ten per cent could in fact be paying about fifteen times more.

It would be most helpful to have a note by the end of this week explaining the basis of this estimate, and whether it is the best measure to illustrate this particular point. The Department will presumably wish to agree this with the Treasury and the Central Statistical Office.

The Prime Minister would also be grateful if the Treasury could provide a run of figures for the percentage of total income tax revenue paid by the top ten per cent of taxpayers.

I am copying this letter to Moira Wallace (Chancellor of the Exchequer's Office), Simon Judge (Paymaster General's Office), Roger Bright (Department of the Environment) and Jack Hibbert (Central Statistical Office).

EXCHEQUER	
14 APR 1988	
Mr Culpins	
PS/CST	PS/F&T
Mr Hawtin, Mr Riley &	
Mr RCG Allen, Mr Pichford	
Mr Feltpelt & Mr Scales	

*Handwritten:* 14/4

PAUL GRAY

Alan Riddell, Esq.,  
Minister for Local Government's Office,  
Department of the Environment.



3 MARSHAM STREET  
LONDON SW1P 3EB  
01-212 3434

My ref:

Your ref

Paul Gray Esq  
Private Secretary to  
The Prime Minister  
10 Downing Street  
LONDON  
SW1A 2AA

CHIEF SECRETARY	
REC.	14 APR 1988
NAME	Mr Potter
TELE	2
TO	Mr Anson, Mr Phillips
	Mr Hamilton, Mr McIntyre
	Mr Turnbull, Miss Pearson
	Mr Gibson, Mr Felgett
	Mr Call

14 April 1988

Dear Paul

COMMUNITY CHARGE REBATES

Following this morning's discussion at Cabinet, I enclose a copy of the statement which my Secretary of State will be issuing this evening and on which he will be drawing at the meeting of the Conservative Backbench Environment Committee.

The substance of the statement is also to be incorporated in an Answer, also to be given at 5.30pm this evening, pursuant to an earlier PQ from Eric Forth MP. I would be grateful if recipients of this letter could ensure that the confidentiality of the statement is observed until then.

Copies go to Alex Allen (Chancellor of the Exchequer's Office), Jill Rutter (Chief Secretary's Office), Alison Smith (Lord President's Office), Murdo Maclean (Chief Whip's Office), Geoffrey Podger (DHSS), David Crawley (Scottish Office) and Jon Shortridge (Welsh Office) and also to Trevor Woolley (Sir Robin Butler's Office).

Yours sincerely  
Roger Bright

R BRIGHT  
Private Secretary



**COMMUNITY CHARGE - HELP FOR THOSE ON LOW INCOMES**

The Government has today announced new and improved arrangements for the reduction of community charges paid by people on low incomes. These will reduce community charges for some one million people who would have paid charges in full. It will reduce further the charges paid by another 4 million people eligible for rebates of up to 80%.

Under the Government's existing proposals, all those receiving income support - the successor to supplementary benefit - will have their rates, or in future their community charge bills, reduced by 80%. So they will pay only 20% of the community charge for the area in which they live. In addition, their income support will include an amount to help meet the 20% charges that they do have to pay.

Those with incomes above the income support level will also be eligible for rebates of up to 80% according to their circumstances. In 1988/89, with domestic rates, the amount of their rebate is reduced by 20 pence for each £1 increase in their income. The Government has now decided that, when the community charge is introduced, rebates should be calculated on the basis of a lower 'taper', of 15 pence for every additional £1 of income. This means that the amount of community charges of those on low incomes will rise more slowly as their incomes increase. Their rebate will be reduced by only 15 pence for every £1 rise in their net earnings above the income support level.

This reduced taper will come into effect when the community charge is introduced - in Scotland in 1989 and in England and Wales in 1990.

Four million people will receive the maximum 80% reduction. If a 20% taper had been used for the community charge, about a further 4 million people would have received reductions of up to 80%. With a 15 pence taper, rebates will extend further up the income scale. One million additional adults will have

their community charge bill reduced. About 9 million people will pay reduced charges, and about 5 million people with incomes above the income support level will have larger reductions in community charge than they would have had with the 20 pence taper.

Of these 5 million, about three quarters are people who do not pay income tax.

This improvement in the rebate proposals achieves a better targetted result than the New Clause I proposal for a 50% community charge for those who do not pay income tax. But it does so by a simpler and much less bureaucratic route, with no anomalies, and one that avoids the earnings trap which New Clause I would produce. It does not require an amendment to the Local Government Finance Bill.

mp

BF 1574



DEPARTMENT OF HEALTH AND SOCIAL SECURITY

Richmond House, 79 Whitehall, London SW1A 2NS

Telephone 01-210 3000

From the Secretary of State for Social Services

CHIEF SECRETARY	
REC.	14 APR 1988
Mr Potter	
Mr Hansen	Mr Phillips
Mr Hawton	Mr McIntyre
Mr Tomball	Miss Pearson
Mr Carlson	Mr Felgett

Ch/minutes of No 10 meeting behind. See X over for Mr Moore's next bid. mpw 15/4

The Rt Hon Nicholas Ridley MP  
Secretary of State for the Environment  
Department of the Environment  
2 Marsham Street  
London  
SW1P 3EB

14 April 1988

Mr Call

Dear Mr Ridley

COMMUNITY CHARGE REBATES

I have seen Roger Bright's letter of 13 April to Paul Gray. I do recognise the political problem presented by the Michael Mates amendment, and the need for a quick response attractive to our supporters. Equally, colleagues should be aware of the implications of your proposals.

First, it will do nothing for those on low incomes with capital over £6,000 - precisely the group causing so much concern to our supporters at the present because of their losses under the new social security scheme. We are bound to be asked why we can move on the taper but not on the capital limit.

Second, a major plank of our defence of the reforms has been the need to reduce dependency. Your proposal - with a substantial increase in the number receiving means tested benefits - runs directly counter to this.

I must also point out that the proposal would have indirect consequences for public expenditure - both administration and benefit - as well as the direct cost in additional rebates. It is, I hope, understood that I would not be expected to meet any of these costs from within my own programme.

Subject to these points, I would be willing to go along with your proposal. It is worth adding one further point. If we can kill the Mates amendment in this way, it will be politically vital to be able to demonstrate that the poorest have been adequately protected



E.R.

against the costs of the community charge. This means that the level of compensation built into the income support rates for the 20 per cent contribution to the charge will be closely scrutinised, and that we will face serious political problems if it is not at a realistic level. I will write to you further on this point in due course.

X

Copies to the Prime Minister, the Chancellor, the Chief Secretary, the Lord President, the Chief Whip, and the Secretaries of State for Scotland and Wales.

*Yours sincerely*

*RD Clark*

PP

JOHN MOORE  
(approved by the Secretary of State  
and signed in his absence)



Paul Gray Esq  
 Private Secretary to  
 The Prime Minister  
 10 Downing Street  
 LONDON  
 SW1A 2AA

CH/EXCHEQUER	
REC.	14 APR 1988 ✓ 14/4
ACTION	CST
COPIES TO	

2 MARSHAM STREET  
 LONDON SW1P 3EB  
 01-212 3434

My ref:  
 Your ref:

14 April 1988

*Dear Paul*

COMMUNITY CHARGE REBATES

Following this morning's discussion at Cabinet, I enclose a copy of the statement which my Secretary of State will be issuing this evening and on which he will be drawing at the meeting of the Conservative Backbench Environment Committee.

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Copies go to Alex Allen (Chancellor of the Exchequer's Office), Jill Rutter (Chief Secretary's Office), Alison Smith (Lord President's Office), Murdo Maclean (Chief Whip's Office), Geoffrey Podger (DHSS), David Crawley (Scottish Office) and Jon Shortridge (Welsh Office) and also to Trevor Woolley (Sir Robin Butler's Office).

*Yours sincerely*  
*Roger Bright*

R BRIGHT  
 Private Secretary

## COMMUNITY CHARGE - HELP FOR THOSE ON LOW INCOMES

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their community charge bill reduced. About 9 million people will pay reduced charges, and about 5 million people with incomes above the income support level will have larger reductions in community charge than they would have had with the 20 pence taper.

Of these 5 million, about three quarters are people who do not pay income tax.

This improvement in the rebate proposals achieves a better targetted result than the New Clause I proposal for a 50% community charge for those who do not pay income tax. But it does so by a simpler and much less bureaucratic route, with no anomalies, and one that avoids the earnings trap which New Clause I would produce. It does not require an amendment to the Local Government Finance Bill.



2 MARSHAM STREET  
LONDON SW1P 3EB  
01-212 3434

My ref:

Your ref:

The Rt Hon Douglas Hurd CBE MP  
Home Office  
50 Queen Anne's Gate  
LONDON  
SW1H 9AT

CH/EXCHEQUER	
REC.	15 APR 1988
ACTION	CST
COPIES TO	

15/4 April 1988

Dear Douglas

1989/90 RSG SETTLEMENT: OPERATION OF THE EXPENDITURE WORKING GROUPS

Thank you for your letter of 21 March about how we should operate the remit for the Expenditure Working Groups. Kenneth Clarke wrote to me on 21 March, John Moore on 28 March and Peter Walker on 30 March, and Kenneth Baker wrote to you on 17 March.

I am grateful for your agreement that officials should pursue vigorously opportunities for efficiency and other savings. I accept that since you control police establishments one major component of costs is determined by your Department, and hence there may be less scope for the Expenditure Working Groups to identify major savings on this item. But for Police and also Fire, as with all services, there should nevertheless be scope for increased efficiency and reduced costs in the organisation and management of resources. I hope that your officials will press very hard on these points, and if no or insufficient savings emerge that their agreement to the projection will be suitably qualified.

Similarly, I welcome the support of Kenneth Clarke, John Moore and Peter Walker. In particular, I welcome the fact that officials in DES and DHSS have previously taken a firm line on savings and withheld agreement to elements of local authority bids. But I hope that this year colleagues will ask officials to go further and identify the scope for savings in existing arrangements. The Audit Commission has identified scope for potential value improvements totalling many million pounds annually, which could be achieved in a number of service areas. It is not unrealistic to expect these large potential savings to be reflected in the group's projections of expenditure needs.

Copies of this letter go to E(LF) colleagues and to Sir Robin Butler.

*Nicholas Ridley*

NICHOLAS RIDLEY

UNCLASSIFIED

FROM: H C BURNS *pur*

DATE: 15 April 1988

1. MR POTTER *BP 514* ~~*1/15/88*~~  
 2. FINANCIAL SECRETARY

cc PS/Chancellor  
 PS/Chief Secretary  
 Sir P Middleton  
 Mr Anson  
 Mr Phillips  
 Mr Monck  
 Mr Hawtin  
 Mr Fellgett  
 Mr Tyrie  
 Mr Call  
 Mr Jaundoo (IR)  
 Mr Morgan (CVO)

### NON-DOMESTIC RATE TRANSITION

Mrs Chaplin of the Institute of Directors (IOD) wrote to you on 16 February and on 11 March; and Mr Grylls MP of the Small Business Bureau wrote on 17 February. The letters concern the **information available to assess the effects of the 1990 rating revaluation** and move to a National Non-Domestic Rate on business rates bills. Mrs Chaplin's second letter seeks an assurance that business will be consulted before regulations are made on a transition scheme. Draft replies are attached.

2. This submission also advises on a point about "zoning", mentioned in Mr Clarke's letter dated 1 February (received 1 March) to Mr Ridley, which Mr Clarke said he may take up with you separately.

### Background

3. Following the Chief Secretary's discussions with Mr Ridley at the beginning of March, **no official study of the revaluation effects is planned before the revaluation itself begins in July.** **In the Summer the Valuation Office (VO) will collect sample information as the revaluation proceeds.** Information now available is inadequate to assess the distribution of gains and losses from revaluation; there are only estimates of average effects on various

categories of business in different areas. Although rental forms are now being returned to valuers, the information does not yet produce an adequate assessment of the impact on all types of business.

4. The Chief Secretary agreed the principles of the transitional arrangements at a meeting with Mr Ridley on 2 March. Their agreement was that new rates bills would be phased in by placing an annual percentage limit on increases, matched by the deferral of gains, over a five year transition period. (The IOD acknowledge, in their first letter, that the transition should be self-financing.) Until full information is available numerical limits on increases and reductions cannot be set.

5. E(LF) on 14 April agreed that there should be a lower annual percentage limit for small businesses but concluded that further consideration needed to be given to the way the scope of this should be defined. Mr Ridley will make an announcement to that effect. It is still the intention that specific proposals for both schemes will be announced in the Autumn when regulations are made; this would allow business some 18 months before the new bills come into effect. Amendments will be made to the Local Government Finance Bill to allow for these transitional arrangements, and for further arrangements to deal with the remaining effects of the 1990 revaluation and the next revaluation in 1995.

6. Regulations will be based on the best information available (and may require minor adjustment as more comes in). You can assure Mrs Chaplin that businesses will be consulted on the regulations, in the light of information revealed by the VO sample survey.

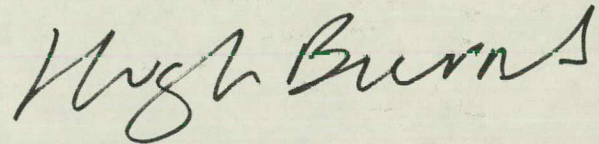
### Zoning

7. The Small Business Bureau also showed some concern that the valuation technique of zoning would further increase the impact on small firms. This is a technique which is only applied to shops. The immediate shop frontage area is given a higher rateable value than the back area and the technique is necessary to establish

rateable values for (the majority of) shops where current rental information is inadequate. Smaller shops tend to have a much higher proportion of their floor space in the higher rateable zones and so pay a higher level of rates per square foot overall.

8. The Chief Valuer's Office have advised that the technique does not discriminate; rentals tend to be calculated by landlords with the shopfrontage in mind. There is therefore a sound financial basis for the technique.

9. The question of zoning can be addressed fully if Mr Clarke writes again; I suggest you need not respond to him at present. A more comprehensive brief can be prepared if you wish.

A handwritten signature in cursive script that reads "Hugh Burns". The signature is written in dark ink and is positioned to the right of the main text.

H C BURNS



7/012

DRAFT LETTER

Mrs Judith Chaplin  
Institute of Directors  
116 Pall Mall  
LONDON  
SW1Y 5ED

Thank you for your letters of 16 February and 11 March.

I appreciate your concern and your desire to keep your members informed about the likely effects of the forthcoming rate revaluation. However, reliable information is not yet available on the distribution of gains and losses. Forecasts at the very broad level undertaken by some private firms of Surveyors are not sufficiently detailed to help us in planning the transitional arrangements, which will require much more detailed information. As the revaluation itself proceeds, starting in the Summer, the valuation office will be collecting sample information which will provide a good indication of the likely effects of the revaluation itself.

I can assure you that business organisations will have an opportunity to comment on the information and the Government's proposals before the regulations are made.

[NL]

7/015

DRAFT LETTER

Michael Grylls Esq MP  
Chairman  
The Small Business Bureau  
32 Smith Square  
LONDON  
SW1P 3HH

Thank you for your letter of 17 February.

I appreciate your concern and your desire to keep your members informed about the likely effects of the forthcoming rate revaluation. However, reliable information is not yet available on the distribution of gains and losses. Forecasts at the very broad level undertaken by some private firms of Surveyors are not sufficiently detailed to help us in planning the transitional arrangements, which will require much more detailed information. Those revaluation forms of return which, as you mentioned, are being returned to the Inland Revenue will not be received in sufficient number to permit a full analysis until the Summer.

As the revaluation itself proceeds, starting in the Summer, the valuation office will be collecting sample information which will provide a good indication of the likely effects of the revaluation itself.

The Government has always recognised that there will be a need to protect those businesses which would otherwise face the immediate impact of large increases in their rate bills, as a result of the combined effect of the revaluation and the move to a National Non-Domestic Rate. <sup>Michael Riley</sup> The ~~Secretary~~ of State for the Environment has made our proposals in detail to the Committee on the Local Government Finance Bill on 3 March (an extract from Hansard is

attached). There will be an annual percentage limit on increases in rates bills, with a corresponding defferal of gains, over the five years between 1990 and 1995. Mr<sup>412</sup> Ridley has made clear that he will take power to extend this period for the largest changes, if necessary. The Government is giving special consideration to the position of small businesses.

[NL]

**Mr. Shaw:** I shall be brief as we are anxious to hear what the Secretary of State has to say because it will be important for business. Both small and large business should be supported. If we do not speak up for them we cannot rely on anyone else to do so.

While the community charge and the uniform business rate are good bases for local government finance raising, revaluation will have a major effect and will have many strange results, especially in the south of England where costs will increase substantially.

The amendments are probably flawed in minor detail, but the sentiments behind them are correct. Business will be asked to accept an unreasonable burden and those of us with business experience are aware that today business planning is carried out not for six months or a year but for five years ahead. Let us imagine what it has been like for businesses in council areas where rate increases of 60 and 70 per cent. have become the norm. It has been impossible for businesses to plan. The Government must be seen to be mitigating the effects of revaluation as much as possible.

If the increase in any one year is much over 10 or 15 per cent., that could affect investment or staff numbers. Recruitment may be deferred or delayed. One of the curious aspects of such tax and rate increases is that they tend to be taxes on success. A company may be making quite large profits according to its accounts, but it needs those profits to generate more investment. Investment might be deferred in successful businesses—those that we most need in this country.

There have been rumours that the Department of the Environment is sympathetic to the problem and the Secretary of State may confirm that, but some of us are anxious about my right hon. Friend and his civil servants being able to convince the Treasury. Even if he is unable to go into detail, I hope that he can tell us on Report that he has won all the battles with the Treasury, which should be sympathetic to the plight of both small and large businesses.

I am not asking for the amendments to be accepted today, but for some understanding and perhaps some action.

**Mr. Ridley:** We have had a very good debate which, for once, was not too wide-ranging. That may be because my hon. Friends stuck closely to the subject.

The figures being bandied about on the levels of rate increases for businesses are an unreliable guide to the impact of revaluation. It is too easy to take particular examples as the basis for alarmist speculation. Those arguing for concessions will naturally draw attention to the worst examples, but they are in no better position to know the true outcome of revaluation than we are. No one—not even the chief valuation officer in the Valuation Office—will know the figures until revaluation is complete.

My hon. Friend the Member for Harrow, East (Mr. Dykes) referred to an 18 times increase for hoardings. It is impossible for me to comment on that. It is probably the highest figure that he could think of, but I do not believe that it is likely. The hon. Member

for Truro (Mr. Taylor) told us last Tuesday that all the values in Truro would increase enormously, simply because he had been to school there. That may be a factor, but I doubt it.

The hon. Member for Birmingham, Perry Barr (Mr. Rooker) referred to a grocer shop in the constituency of my hon. Friend the Member for Birmingham, Northfield (Mr. King). To maximise the horror stories, as the hon. Gentleman calls them, he referred to the community charge and the full safety net and explained that it was perfectly proper for him to do so. However, he talks about the business rate after transition and not before it. If he wants to compare like with like, let him compare pre-safety net and pre-transition rates. My hon. Friend the Member for Northfield has such patience and tolerance that he has not sought to intervene in the speeches made by the hon. Member for Perry Barr, but I think that he would like that point to be stressed on this occasion.

Only when the national picture has emerged will we be able to get a clear view of the poundage for the uniform businesses rate and assess the impact on each business. An impression has been conveyed that all businesses will be losers, but that cannot be the case. There is no reason not to believe that there will be at least as many gainers as losers. To be fair, the National Federation of Self Employed, whose examples have been widely quoted in the Committee, also circulated examples of significant gains such as 47 per cent. for a shoe shop in Gloucestershire, although I do not know whether it is in my constituency, 32 per cent. for a shop in Hull and 62 per cent. for a shop in Prestatyn. But the balance of large losses that it shows is not credible if it is taken to indicate the broad pattern of the revaluation, so I do not think that that is likely to be the consequence.

A number of hon. Members suggested different annual progressions from where we are now to where we will be after revaluation, but I am not sure whether they had the matter straight. The hon. Member for Perry Barr and my hon. Friend the Member for Chichester (Mr. Nelson) seemed to think that if the figure was 20 per cent. it would be 20 per cent. of the gap in each year of the transitional period. I believe that the thinking of my hon. Friend the Member for Bournemouth, West has been that we would limit increases to 20 per cent. above current rate bills in each year, which is a very different concept. If there were to be a very large increase, 20 per cent. a year on the basis that I am describing would take far longer than on the basis of 20 per cent. of the gap suggested by the hon. Member for Perry Barr.

**Mr. O'Brien:** Given that there could be a large gap because of revaluations, does the Secretary of State believe that there will be many appeals against revaluation? It could take a great deal of time to determine valuations because of the number of appeals brought to the valuation courts. Does he think that that is likely to cause problems?

**Mr. Ridley:** Probably there will be quite a lot of appeals, but that will depend on how people regard their assessments for valuation. However, we expect

[Mr. Ridley]

to be able to cope with those appeals, so I do not believe that that is relevant to my argument.

My hon. Friend the Member for Kensington (Sir B. Rhys Williams) suggested a 10 per cent. limit while my hon. Friend the Member for Bournemouth, West and the hon. Member for Dumbarton (Mr. McFall)—especially in relation to shops in the case of the latter—suggested a limit of 15 per cent. I take those figures to mean, first, that they are added to the rate of inflation and, secondly, that they are limits on the amount by which rates bills would increase in each year. The hon. Member for Dumbarton cited an example of manufacturers in London and said that theirs would be going up two to four times and they will almost certainly be gainers because the likely multiplier or divisor is between five and six times. It is obvious that the hon. Gentleman has not got the point that it is not the amount by which it goes up but the amount by which it goes up relative to the average.

We cannot know how long a period of transition would be appropriate until we know the real figures more accurately. The Government have accepted that the largest increases should be phased in over at least five years and we have always made that clear. I am sure that the Opposition will agree that the size of the maximum annual increase, whether of 10, 15, 20 per cent. or any other percentage, which we propose to set under clause 43 should depend to an extent at least on the size of the gap that is to be bridged.

6.45 pm

I can give an assurance that I am well aware of the need to allow enough time for businesses to absorb the changes in their rate bills, especially the increases, and for those increases to be taken into account in future rent negotiations with landlords. There was wide discussion of that point. My hon. Friend the Member for Kensington was right to draw attention to the severe problems that will occur in inner London, and we have not sought to disguise them. On the other hand, hon. Members may have tended to underestimate the extent of the effects of keeping rates down. Worthy boroughs such as Kensington have kept rates down in inner London. That has had the effect of allowing landlords to drive up rents to high levels. The future effect of higher rates will be to force landlords to drop rents because there is a limit to how much small businesses can pay in combined rent and rates.

That is an important reason why we should allow sufficient time for those processes to happen. I point out to my hon. Friend for Bournemouth, West that many such agreements have rent clauses which allow for no falls but only increases. However, if landlords think that they are in danger of having no tenants those clauses will disappear like snow in May. Landlords will drop rents as soon as they realise that they must do so to ensure that they have tenants.

My hon. Friend the Member for Stockton, South (Mr. Devlin) made an excellent speech. I should like to follow him into the realms of the pamphlet that he mentioned, but I shall not do so as I know that

you, Sir Michael, do not like to be late for your dinner. Many anomalies will arise in not only the north but throughout the country. That is why a good transitional system is vital if we are to introduce the new system without too much turmoil.

**Mr. Rooker:** We have to wait until revaluations have been carried out, but does the Secretary of State have a maximum time limit in mind? Surely the matter is not open ended, although the end of the century or 10 years could be thought reasonable in some circumstances. If the right honourable Gentleman is coming to that matter, I shall await his reply.

Secondly, if, all of those landlords and owners of property will be going round the country telling their tenants, "Of course you can have rent reductions", have there been any discussions with the investors of pension funds about the consequences that might flow from that?

**Mr. Ridley:** I shall come to the hon. Gentleman's first point in my own time if I may. In regard to his second point, it is not for me to comment on how the pension funds will find the next way of improving their position but I am sure that they are perfectly capable of making that decision.

In regard to paying for any transitional arrangement, I am sure that the Committee will accept the point made by my hon. Friend for Romsey and Waterside (Mr. Colvin) that the limits on any rate bill increases will have to be matched by the deferral of gains which would otherwise be due. Otherwise, the total yield of the business rate would be reduced. Obviously, those who stand to gain are those who have been paying too much for some time. I know that my hon. Friend the Member for Kensington was hoping for me to mention a more cheerful policy, but it must be right that in deciding by how much to limit annual increases we should take account of the impact on those who have legitimate expectations of some relief. There will inevitably be a cost of protecting those who lose and it will be necessary to arrange for offsetting limits on the rate at which gains can be taken. In addition, the system will not be entirely symmetrical. Any limits may have to be in the form of an X percentage limit on increases and a matching but probably different limit on reductions if we are to achieve the objective that the effect on the pool as a whole should be neutral.

It may also be the case that a small premium addition to the UBR poundage under the provisions of paragraph 7 of the schedule might be required, at least in the first half year, if the factors that I have just quoted are not to produce an unreasonable imbalance. As far as possible, we shall seek to match the concessions to the losers with the limit on the gainers' gain.

Amendment No. 661, tabled by my hon. Friend the Member for Bournemouth, West, seeks a limit under traditional arrangements as they apply to small businesses. I have hitherto been talking about all businesses. The amendment suggests a dividing line between small and large businesses as a rateable value at current levels of £15,000. I am afraid to say too

much in welcoming that proposal because I may be accused of ideological impurity by my hon. Friend the Member for Canterbury (Mr. Brazier). Nothing daunted, I find my hon. Friend's idea acceptable in principle, but I should like to consider the proposal in more detail, especially the dividing line. I am attracted to the scheme because it proposes different transitional regimes for large and small businesses rather than different end states. It is not wrong in principle to say that large businesses could be limited to annual increases of X per cent. and matching limits on reductions and small businesses could be limited to X minus 5 per cent. increases, with matching limits on reductions in their rates bills in real terms.

There are problems about setting a dividing line by reference to rateable value, as the hon. Member for Newcastle upon Tyne, Central (Mr. Cousins) and others have rightly said, because any particular rateable value chosen will involve very different properties in different parts of the country. There are particular problems because of the high values in inner London which my hon. Friend the Member for Kensington ensures that we take into account. Any property might cross the boundary in the five year period. If there were an appeal and the appellant were successful and his rateable value dropped below £15,000—I use that figure as an example; I do not necessarily accept it—he would fall into a different transitional regime from the previous one. That must be taken into account because although it is a detail of the proposal it could happen. Because of extensions to the building, property might cross the boundary in the other direction if it were updated. I shall be happy to consider such a scheme when I make regulations under clause 43 in the autumn. I fear that that must be without commitment at the moment because, as I have said, we do not yet know the figures with which we shall be dealing, and we cannot fashion such a scheme until we do. Nor is it certain that, having studied what I have said today, the representatives of large and small businesses will agree that the suggestion is a good idea. We shall have to listen to the views of industry before going firm on such a scheme.

In considering whether there should be a 10, 15 or 20 per cent. increase, hon. Gentlemen will realise that if I were to follow the scheme proposed by my hon. Friend the Member for Bournemouth, West, there would be considerable complications. The figures that have been bandied about are mostly haywire and as we do not know what the real figures are I cannot recommend a percentage to the Committee. I have spoken about a 5 per cent. differential, but if I were to be specific now—I should almost certainly have to return to the House in the summer and say, "I am sorry, but I got it wrong on 3 March—I made a guess, but it has turned out not to be very satisfactory." That would achieve nothing. However, I hope that what I have said will encourage people to feel that the Government wish to respond to the spirit of the debate.

I turn now to amendment No. 360, tabled by my hon. Friend the Member for Kensington. I am happy to tell him that I am prepared to meet that amendment on Report. He will forgive me if I seek

to redraft it. I am certain that under any of the schemes that we have been discussing the transition will not be over for all businesses by 1995. That should not be taken as a sign of panic or pessimism because at least a handful of businesses will face large rises mainly because their value is far too low at present. It is unlikely that we shall sort out all the problems in the system in the first quinquennium. We should wait until the next revaluation in 1995. My successor will be handling the matter and he—

**Mr. Rooker:** Or she.

**Mr. Ridley:** Or she. He or she will be from the Conservative party. My successor will want to take into account the results of the second revaluation and the numbers still in transition, and will probably design a different and better scheme suited to the needs at the time. All that we need to do now is to take power for the second transitional scheme to be put into effect nearer the time. I hope that my hon. Friend will feel happy to seek leave to withdraw his amendment so that I can table an appropriate amendment on Report.

**Mr. Butterfill:** I thank my right honourable Friend for the way in which he has approached the problems that I attempted to identify in my amendment. He recognised the difficulties that will exist for all businesses, especially small businesses, and his suggestion that there should be a 5 per cent. differential between the two is imaginative and helpful. I am pleased that my right honourable Friend was able to respond to some of the anxieties expressed by other members of the Committee. On the basis of his assurances, I beg to ask leave to withdraw the amendment.

**The Chairman:** Order. The hon. Gentleman did not move the amendment.

7 pm

**Mr. Rooker:** I do not wish to delay the Committee, but I wish to protect the rights of anyone who wants to make a small contribution before the magic words are uttered as I assume that the hon. Member for Kensington and Chelsea will seek leave to withdraw the amendment.

The Secretary of State made an interesting speech, which we shall study. He said that it was designed to "encourage people to feel" that the idea was good and that the Government would do something about it. He also gave caveats to the effect that the revaluation and the transitional period will never end. He may criticise the figures, but we have received hundreds of examples throughout the country showing that some will lose and some will gain. The picture is a snapshot from those who have examined the figures. A nursery in Canterbury will have an increase of 722 per cent. It will take a long time to phase that in at 20 per cent. per year.

Who is to pay for that? The Secretary of State answered the question by saying that as the provision will be self-financing and the yield will remain the same, the losers will pay for the gainers. He also said

**IOD**  
Institute of Directors

Mr. Dickson  
you have this  
in hand.  
R.F.

14 MAR 1988

~~Mr. Dickson~~  
Let DR do the report but  
we will need to make an input,  
not just to clearing out 'x's  
considerably overcut.

JHP

Rt. Hon. Norman Lamont MP  
Financial Secretary  
Treasury Chambers  
Parliament Street  
LONDON SW1P 3AG

11 March 1988

Mr. JAUNDGOO IK  
PPS, CST, PMG, EST

1413

Mr. ANSON Mr. KEMP  
Mr. HAWKIN Mr. POTTET  
Mr. CULPIN Mr. HOALE  
Mr. TYRIE PS/IK

NON-DOMESTIC RATES - REVALUATION.

I wrote to you on 17 February urging you to publish as soon as possible preliminary estimates of the outcome of the revaluation to assist the Parliamentary discussions about the phasing arrangements in the Local Government Finance Bill.

Since then the Secretary of State has made the welcome announcement in Standing Committee that he accepts the case for extending the phasing over a longer period than five years and for more generous relief for small business premises. He said that he could not settle the percentage limits on year-on-year increases in rates bills or the length of the phasing period until he knew the outcome of the revaluation and would wish to consult with business organisations before coming to a final decision. He also said that he would be bringing forward regulations under clause 43 "in the autumn".

The implication, therefore, is that preliminary information on the revaluation is to be made available in good time for consultations before those regulations are laid. We would welcome your confirmation that this is correct.

*JHP*

Judith Chaplin  
Head of Policy Unit



# THE SMALL BUSINESS BUREAU

32 Smith Square London SW1P 3HH 01-222 0330

cc Mr Fellgett

*As agreed I have told  
the FSI's office that you  
are in the lead on this topic.*

cc Mr Calder

*Mr Henderson  
Mr Pawley (CVO)*

17th February, 1988.

*Q*  
*15/2*

The Rt. Hon. Norman Lamont, M.P.,  
Financial Secretary,  
H.M. Treasury,  
Parliament Street,  
LONDON SW1P 3AG.

FINANCIAL SECRETARY	
REC.	18 FEB 1988
ACTION	Mr JAWROD II
COPIES TO	PPS, CST, DUG, EST
	Mr. Hawtin
	Mr. Culpin
	Mr. Horace
	Mr. Tynick

Dear Norman,

You will remember I spoke to you the other day in the Lobby about the need to ask the Inland Revenue to work out some figures on the rate revaluation.

As I mentioned I took a delegation consisting of all the main business groups to see Nicholas Ridley on the question of the very high increases that firms would have to pay as a result of revaluation and the non domestic rates. Most of the business organisations produced their own figures as to what the likely effects to revaluation would be. These figures came from individual firms and were calculated by their own professional advisors. Unfortunately, Nicholas Ridley was unable to produce any figures of his own although he strongly claimed that the increases would be nothing like what was being suggested by the business groups. Clearly the Government is not in a very good position if it cannot put forward its own figures.

As I said I understand that already half the forms for revaluation have been returned to the Inland Revenue, and I would therefore hope you may be able to get them to make some calculations. You will be receiving similar requests for this information from the Institute of Directors.

You will be the first to agree, I am sure, that it



The Rt. Hon. Norman Lamont, M.P.

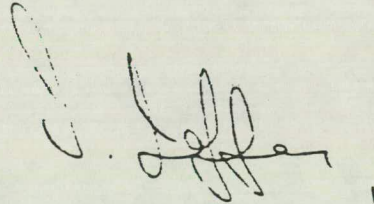
17th February, 1988.

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is not acceptable to leave businesses with so much uncertainty and that business really must know what it has to pay well in advance.

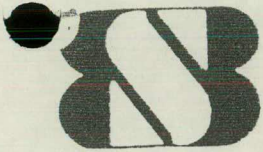
Please forgive me for not signing this letter personally but I have had to leave for an overseas visit.

*Yours sincerely*



20  
Michael Grylls, M.P.  
Chairman.

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# THE SMALL BUSINESS BUREAU

32 Smith Square London SW1P 3HH 01-222 0330

## THE AFFECT OF UNIFORM BUSINESS RATE ON SMALL FIRMS

Whilst it is recognised that a significant part of the rise in rates envisaged when the UBR comes into force is occasioned by the revaluation of property, the new method is likely to impose an added and uneven burden on businesses in the better controlled councils where business rates previously were low (e.g. Kensington and Chelsea). Even though it is apparently part of the Government's aim to encourage businesses to move to the North, businesses in various Northern areas will face similar difficulties.

The increase in business rate will affect small firms more dramatically than large firms because:-

1. Small firms have few premises compared to large firms and the rises will not be able to be averaged with decreases. In addition small premises bear a higher rate due to zoning and other revaluation techniques.
2. Small firms in retailing are likely to face rises due to shop locations whereas manufacturers will face decreases and the large multiple retail stores will be more able to take advantage of the reduction in manufacturer's rates' bills than small firms.
3. In small firms rates account for a higher proportion of pre tax profits (Forum of Private Business estimate 25% for small firms compared to 5% for PLC's).

The evidence of potential inequities has been gathered by NFSE, Forum of Private Business and National Chamber of Trade and is summarised as follows:-

### NFSE Sample 74 of shops offices and factories

71 increases of which 13 would rise less than 50% and 58 would rise more than 50%.

*Life Patron:* The Lord Taylor of Hadfield  
*National President:* Philip Coussens *Chairman:* Michael Grylls, MP  
*Vice Chairmen:* Spencer Batiste, MP Graham Bright, MP Bill Cash, MP Neil Hamilton, MP  
Christopher Kirkham-Sandy, FCA Andrew Rowe, MP Fred Tuckman, MEP

FORUM OF PRIVATE BUSINESS	Sample 2400		
<u>Business</u>	Average	Median	Average
Distribution	+104%	+49%	-6%
Services	+ 72%	+25%	-22%
Manufacturing	+ 10%	-22%	-53%
NATIONAL CHAMBER OF TRADE	Average increase 25% but wide discrepancy from -60% to +240%		
RETAIL CONSORTIUM	Survey of 28 retail companies with 8,487 shops/stores and an average percentage increase of 75%		

CONCLUSION

All the evidence shows that a very large number of businesses are facing a substantial increase in costs. For many small businesses, on whom the Government has relied to revitalise the economy and reduce unemployment, this would be an insuperable problem and would lead to closure particularly in city areas. The most realistic solution is that rises should be limited in any one year for small firms (however defined).

# IOD

Institute of Directors

16 February 1988

Rt Hon Norman Lamont MP  
Financial Secretary  
Treasury Chambers  
Parliament Street  
London SW1P 3AG.

CHIEF SECRETARY	
REC	17 FEB 1988
ACTION: Mr PETER	
- CX EST	
Mr [unclear] Mr [unclear]	
Mr [unclear] Mr [unclear]	
Mr [unclear]	

*[Handwritten signature: A/S]*

*Dear Norman*

NON-DOMESTIC RATES - REVALUATION

I enclose a copy of our letter of 4 February to the Secretary of State for the Environment concerning the need for generous phasing of the introduction of new rateable values and the National Non-Domestic Rate in 1990. Our fears that a significant number of small businesses in particular, in all parts of the country, will face increases of several hundred per cent in their rates bills are shared by the other main business organisations and a joint deputation went to discuss the matter with the Secretary of State on 8 February. We are not raising this matter now to create in any way a lobby against the legislation but because our members are expressing their concern to us and we need to know how to answer them.

The Secretary of State made the remarkable assertion that nobody knows yet what the outcome of the revaluation will be, even in broad terms and therefore there is no point in speculating about what phasing may be required. This was despite the fact that some of the figures placed before him by the organisations had been prepared in conjunction with district surveyors.

It would be unacceptable for businesses to have no official indication of what the likely National Non-Domestic Rate is and the phasing arrangements before publication of the valuation lists on 1st January 1990. Businesses need to plan ahead and they are already very concerned about the impact of the changes in 1990. I am writing, therefore, to ask if you can help to throw any light on this matter by publishing preliminary estimates of the effects of the revaluation before Part III of the Local Government Finance Bill is debated in Committee. The crucial point to know is the distribution of increases, preferably by region. We understand that district valuers have been monitoring all new lettings in their areas for some time now and have received over 50% of the revaluation forms already. We cannot, therefore, believe that the valuers do not now have a pretty shrewd idea of the shape of the final outcome.

it is in the interests of the Treasury to ensure that the 1990 changes do not lead to the closure of large numbers of small businesses with a consequent loss of income, corporation and value added tax and national insurance revenues and increase in social security expenditure. We therefore urge you to make available as much information as possible at this stage so that the question of phasing relief can be discussed on an informal basis.

I hasten to add that we accept that it is not realistic to expect the general Exchequer to fund the phasing relief. It will have to be funded by a corresponding phasing of reductions in rates bills.

Mrs Judith Chaplin  
Head of Policy Unit



the department for Enterprise

CONFIDENTIAL

The Rt. Hon. Kenneth Clarke QC MP  
Chancellor of the Duchy of Lancaster and  
Minister of Trade and Industry

Rt Hon Nicholas Ridley MP  
Secretary of State  
Department of Environment  
2 Marsham Street  
LONDON  
SW1P 3EB

Department of  
Trade and Industry

1-19 Victoria Street  
London SW1H 0ET

Switchboard  
01 215 7877

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Fax 01-222 2629

Direct line 215 5147  
Our ref  
Your ref MAZC 14  
Date 2 February 1988

FINANCIAL SECRETARY	
REC.	2 MAR 1988
ACQ.	Mr. Potter,
COPIES 10	CST, Mr Anson,
	Mr. H. Phillips, Mr Hawtin,
	Mr. Turnbull, Mr Fellgett,
	Mr Call, PS IR

*Mr. Potter*

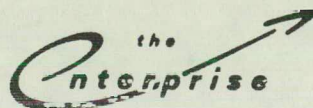
**NATIONAL NON-DOMESTIC RATE:TRANSITION**

I am broadly content with your proposals in your minute of 24 February to the Prime Minister.

I agree, in particular, with your judgment that the transitional arrangements must be complete, for all but the most extreme cases, by the time of the 1995 revaluation, particularly as the safety net arrangements for the Community Charge will end at the time.

Nor would I wish to reopen the decision that the costs of the transitional arrangements for the national non-domestic rate should be met by other non-domestic ratepayers. But I am concerned that the price of doing so might be an increase of as much as 10% in the initial level of the NNDR. If this becomes known, it is bound to reinforce the opposition to the NDDR on the part of the business community. I do not suggest that you revert to the idea of meeting the cost of the transitional arrangements for losers by imposing parallel delays on the rate at which gainers benefit from the NDDR, since many of these will be in the North and in the inner cities. But the presentation of this aspect, and the timing of any announcement of the likely figure, will be very important.

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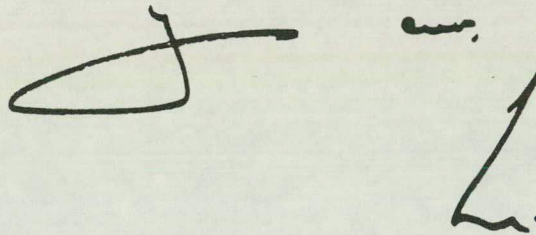


I do not suggest that you now accept an amendment to write an "rpi minus x" indexation formula for the NNDR into the Bill. But the phasing out of the transitional arrangements means that in the first four years the NDDR will in fact rise consistently by less than the rpi. This may be a useful presentational point.

I remain sceptical of a statutory requirement on local authorities to consult business. But I will not oppose a concession on the point if you think it would help.

There is one point not mentioned in your minute which is of serious concern to organisations representing small businesses- the "zoning" method of valuing business premises, which is widely believed to discriminate against smaller businesses. I may wish to take this up with you and with Norman Lamont separately.

I am copying this letter to the Prime Minister, to other members of E(LF), to Norman Lamont and to Sir Robin Butler.

A handwritten signature in black ink, appearing to be 'K. Clarke', written in a cursive style.

KENNETH CLARKE



Minister for Local Government

Department of the Environment  
2 Marsham Street  
London SW1P 3EB

Telephone 01-212 7601

CH/EXCHEQUER	
REC.	15 APR 1988
ACTION	Mr CULPIN
COPIES TO	PS/EST. PS/EST. Mr HAWTIN, Mr RILEY, Mr R.I.G. ALLEN, Mr PICKFORD, Mr FELLGETT, Mr SCOTTER.

✓ 15/4

Ch/ Don't know about X on p3...

15 April 1988

mpw

Dear Paul

Thank you for your letter of 13 April requesting a note on the basis of the estimate that the top 10% of the population by income contribute 15 times as much towards the cost of local services as the bottom 10%.

I attach a note prepared by officials and cleared with Treasury and CSO. It has not yet been seen by Ministers here.

I am copying this letter and attachment to Moira Wallace (Chancellor of the Exchequer's Office), Simon Judge (Paymaster General's Office), Roger Bright (Department of the Environment) and Jack Hibbert (Central Statistical Office).

Yours sincerely  
A. Ridell

ALAN RIDDELL  
Private Secretary

(X) I am afraid it has not yet been possible to secure official Treasury clearance, but I think you will want to have it for the weekend anyway.

Paul Gray Esq





## RELATIVE CONTRIBUTIONS OF HOUSEHOLDS TO LOCAL AUTHORITY SPENDING

1. There are two elements to the assessment of the relative contributions of different households to local spending:

(i) Direct contribution through community charge

Latest estimates suggest that households with the highest 10% of net incomes will pay six times more in community charge than the 10% with the lowest net incomes. This estimate is made from a computer model of the tax benefit system, and reflects the benefit to the 10% of households of the lowest incomes from the rebate system and the fact that the highest income households tend to be those with 2 or more adults which pay more community charges than those in the lowest 10% which are predominantly single pensioner households.

(ii) Contribution from central taxation

Central taxation funds local authority spending through grant paid to local authorities and through rate rebates. The top 10% of households obviously pay more than the bottom 10% in central taxes. CSO make projections of the amount of tax paid by households in different income groups. These projections cover indirect taxes such as VAT and car tax as well as direct taxes such as income tax and national insurance contributions. In addition, an allowance is made for intermediate taxes like employers national insurance contributions and business rates, to take account of the fact that these taxes are partly passed onto households in the form of higher prices. The estimates are derived from the Family Expenditure Survey, a regular sample survey. The 1985 figures showed that the top 10% of households paid some 20 times more in central taxes than the lowest 10%.

The combination of figures calculated at (i) and (ii) above provides the estimate for the combined ratio of contributions by the top and bottom 10% of households to local spending. The calculation which produced the estimate of a ratio of 16 times in August last year is attached. While there is no single right way of calculating this figure, it is agreed that this methodology is defensible.

### Sensitivity

A large number of factors go into the calculation of the ratio. Some analysis was therefore undertaken to establish how sensitive the estimates were to changes in the underlying data. The position seems to be that the ratio can be made to move by more than 1 point by changes in the distribution of income. These are occurring but they are taking place over a number of years and should not produce short term volatility. The ratio is also sensitive to the definition of income used. The calculations have been done on the basis of gross income. This is entirely defensible and does not cause any problem so long as the definition is not changed and it is clear which definition we

using. The ratio may not, however, be sensitive to changes in individual aspects of the tax regime. A reduction in direct taxation for one group may be largely replaced by an increase in indirect taxes or be made up by other behavioural responses.

Following this year's budget, the opportunity has been taken to shade the ratio of contributions to local spending from 16:1 to 15:1. Because the estimates of total tax payments are made retrospectively - to take account of the way in which people actually dispose of their net income - no attempt has been made to make a detailed assessment of the effect of the budget changes on the ratio. The change, therefore, partly reflects the fact that a figure of 16:1 gave a spurious air of precision to a necessarily imprecise figure and recognised the possibility that the radical nature of the budget might show up ultimately as a reduction in the ratio, though on the basis of the sensitivity analysis carried out it is unlikely to have made a difference of more than 1 point.

Σ X

CONTRIBUTION OF RICH AND POOR TO LOCAL AUTHORITY SPENDING

1. The attached table sets out the basic data used to estimate that the highest paid 10% of the population will, after the introduction of the community charge, contribute 16 times as much to local authority spending as the lowest paid 10%. The derivation is as follows (rounding errors apply):-

a) The government contribution to local authority expenditure is through grants and rate rebates. In 1985/86 these amounted to

GRANT	£11,780m
RATE REBATES	<u>£ 1,290m</u>
TOTAL	£13,070m

b) in 1985/86 <sup>domestic</sup> rate income, net of rebates, amounted to £5,140m. Therefore government contributes from central taxation about 2.5 times the amount raised locally.

c) Assuming in table one that only one household exists in each decile, the total raised from households by the community charge equals the sum of the ten values, that is £2,550. Hence the assumed government contribution provided by these households is just over 2.5 times this amount (see b) and equals £6,480.

d) The total amount of tax paid by these ten households is found by summing the individual tax payments, £37,410. The £6,480 which finances local authority spending represents over 17% of this tax payment.

e) Assume 17% of each tax payment is accounted for by Local Authority spending. Thus the contribution to local spending for the highest and lowest decile is calculated as

	HIGHEST	LOWEST
17% OF NATIONAL TAXATION	1840	90
COMMUNITY CHARGE	460	50
TOTAL CONTRIBUTION	2300	140

f) Hence the decile of population with the highest gross income contributes over 16 times ( $2300 \div 140$ ) as much to local authority spending as the lowest gross income decile.

T DAVIS

FLT

21 August 1987

DOC2918LM

TABLE ONE

DECLIE	ANNUAL TAXES PAID BY AVERAGE HOUSEHOLD	AVERAGE REBATED COMMUNITY CHARGE
1 (LOWEST)	501	53
2	750	95
3	1157	158
4	1931	210
5	2750	263
6	3488	289
7	4245	315
8	5422	336
9	6642	368
10 (HIGHEST)	10603	462

SOURCE : ECONOMIC TRENDS NOVEMBER 1986, 108, TABLE 6.

"AVERAGE INCOMES, TAXES AND BENEFITS, 1985

By decile groups of household ranked by gross income.

Taxes paid included income tax and employees NIC; Indirect taxes except rates; and intermediate taxes.

Community Charge figures from Green Paper, Cmnd 9714,

"PAYING FOR LOCAL GOVERNMENT" - Figures increased by 5% to roll forward to 1985/86.

## Average incomes, taxes and benefits, 1985

By decile groups of households ranked by gross income

TABLE 6

	£ per year										Average over all decile groups
	Decile group										
	1st	2nd	3rd	4th	5th	6th	7th	8th	9th	10th	
Decile points (£)	2 904	4 024	5 343	7 218	9 042	11 007	13 181	15 885	20 547		
Number of households in the sample	701	701	702	701	701	701	701	702	701	701	7 012
Original income	241	697	1 544	3 962	6 560	8 710	10 972	13 560	17 012	27 429	9 068
Direct benefits in cash											
Contributory											
Retirement pension	1 300	1 473	1 431	912	480	381	280	217	290	200	696
Unemployment benefit	37	53	92	81	97	78	63	40	50	33	62
Sickness/ injury related	67	89	179	248	174	157	128	78	97	57	128
Other contributory benefits	67	85	69	102	69	95	55	53	33	30	66
Total contributory benefits	1 471	1 699	1 771	1 343	820	711	526	388	470	320	952
Non-contributory											
Supplementary benefit	265	440	593	380	221	156	103	71	65	80	238
Child benefit	24	97	192	236	292	288	303	341	281	279	233
Rent rebates/ allowances	345	413	355	145	76	32	26	19	2	4	142
Sickness/ disablement related	20	64	102	151	107	50	77	53	62	58	74
Other non-contributory benefits	35	37	61	77	83	82	41	59	58	47	58
Total non-contributory benefits	689	1 051	1 303	989	780	608	551	544	468	468	743
Total cash benefits	2 160	2 750	3 074	2 332	1 600	1 319	1 077	931	939	789	1 697
Gross income	2 401	3 447	4 618	6 294	8 160	10 029	12 040	14 401	17 930	28 218	10 765
Income tax and Employees' NIC											
Income tax	19	70	154	502	944	1 315	1 807	2 335	3 178	5 871	1 620
National insurance contributions	6	11	50	196	390	547	698	866	1 048	1 358	517
less: Tax relief at source <sup>1</sup>	15	21	35	77	150	221	288	350	379	491	203
Total	10	60	169	621	1 184	1 641	2 216	2 851	3 846	6 738	1 934
Disposable income	2 391	3 387	4 449	5 672	6 975	8 388	9 833	11 641	14 104	21 480	8 832
Indirect taxes											
Domestic rates <sup>2</sup>	131	171	221	292	337	369	389	445	465	577	340
Taxes on final goods and services											
VAT	146	211	309	435	534	637	723	932	1 063	1 520	651
Duty on tobacco	79	122	167	201	206	238	220	220	228	251	193
Duty on beer	17	23	40	58	73	99	100	134	140	185	87
Duty on wines	5	5	9	12	19	19	28	34	49	91	27
Duty on spirits	17	19	37	43	54	56	57	94	98	147	62
Duty on hydrocarbon oils	19	28	49	81	109	138	160	202	237	308	133
Car tax	2	2	8	9	18	20	30	34	43	67	23
Vehicle excise duty	9	19	32	44	60	69	78	91	106	133	64
Television licences	29	35	38	39	42	44	45	46	47	48	41
Stamp duty on house purchase	2	1	2	4	7	8	11	18	22	30	11
Customs' duties	7	11	16	20	26	30	34	41	47	62	29
Betting taxes	7	18	23	32	34	39	49	41	34	56	33
Other	9	11	13	14	15	18	19	25	23	29	18
Intermediate taxes											
Commercial and industrial rates	45	58	75	97	114	132	145	178	203	288	133
Employers' NI contributions	50	65	86	112	132	154	170	208	238	340	156
Duty on hydrocarbon oils	22	29	38	46	56	65	71	85	96	137	65
Vehicle excise duty	6	7	10	13	15	18	19	24	27	39	18
Other	20	27	36	46	54	63	70	85	95	134	63
Total indirect taxes	622	861	1 209	1 602	1 903	2 216	2 418	2 936	3 261	4 442	2 147
Income after cash benefits and all taxes	1 768	2 526	3 241	4 070	5 072	6 173	7 415	8 704	10 844	17 038	6 685
Benefits in kind											
National	113	187	403	535	619	674	687	796	768	818	560
Educational	644	795	879	770	701	722	700	695	686	731	732
Housing subsidy	90	106	116	86	62	60	50	42	29	14	65
Rail travel subsidy	6	8	15	27	26	41	36	31	62	109	36
Bus travel subsidy	34	39	45	33	30	31	28	29	30	38	34
Welfare foods	5	25	59	49	49	25	17	23	18	15	28
Total	891	1 161	1 517	1 500	1 487	1 553	1 518	1 616	1 591	1 726	1 456
Final income	2 660	3 687	4 758	5 570	6 559	7 726	8 933	10 320	12 435	18 764	8 141

1 On mortgage interest and life assurance premiums.

2 Net of the rate rebate element of housing benefit, but including water, etc. charges.

1. MR POTTER <sup>BHP</sup> 15/4
2. CHIEF SECRETARY

FROM: R FELLGETT

Date: 15 April 1988

cc: PS/Chancellor  
 PS/Financial Secretary  
 PS/Paymaster General  
 Sir Peter Middleton  
 Mr Anson  
 Mr Phillips  
 Mr Scholar  
 Mr Hawtin  
 Mr Culpin  
 Mr R I G Allen  
 Mr Pickford  
 Mr C Riley  
 Mr C Ford  
 Mr Tyrie  
 Mr Call

#### THE COMMUNITY CHARGE AND THE BUDGET

Mr Howard's letter dated 28 March to the Financial Secretary concerns the argument that the Community Charge is not unfair, because high income households will continue to contribute more to local authority revenue than low income households. This is partly a consequence of rebates, and partly because Exchequer grant (financed by progressive central taxation) forms such an important part of local authority revenue.

2. This submission covers a draft reponse to Mr Howard. It also offers advice on the request, in Paul Gray's letter of 13 April to Mr Howard's office, for a note on the basis of DOE's estimate of the relative contribution of rich and poor households.

3. In view of this correspondence and the No.10 remit, we have looked again at the available estimates. Our view is that it is not unreasonable to argue that the top 10% of households by income would, on 1985 grant and tax arrangements, if the Community Charge system had been in place, pay around 15 times as much as the bottom 10%. This is the figure which Mr Howard

quoted to the Prime Minister, and which she used in the House yesterday. It is also the one that we thought we had agreed with DOE officials last summer. (The actual DOE calculation then produced a figure of 16, which we thought over-precise.)

4. In response to the No.10 remit, DOE are today preparing a description of the derivation of this ratio, which they will clear with us. That will defend the ratio of "about 15".

5. There are considerable uncertainties about any such estimate, which must be subject to a wide margin of error. In particular, this figure:

(i) is based on sample data about 1985 income and tax payments; changes since then in the distribution of incomes and taxes, the proportion of local authority revenue formed by grant, and the recent announcement about rebates, will all have changed the number (although not all in the same direction);

(ii) ranks households by gross income (which includes benefit payments) rather than original income (which does not). Using original income would give a somewhat lower figure of about 13;

(iii) covers only local authority rate fund revenue in England. Including other revenue, for example borrowing or housing revenue, or including Scotland or Wales would be liable to alter the figure;

(iv) adopts a fairly naive treatment of company taxes, and in particular the extent to which these are attributed ultimately to persons.

6. In the light of these points we think the DOE estimate for 1985 could be if anything a little on the high side. A slightly lower figure of 13 might be more appropriate, but a figure of about 15 remains defensible.



7. It would be possible to do some more work to refine the DOE estimate. We could, for example, attempt to project the estimates forward from 1985 to 1988 using the information on income distribution underlying the Budget costings. We could also look further into some of the issues listed above. But the number would still probably be subject to a good deal of uncertainty, and there may be little to gain from producing a more refined estimate. But if you wish we could pursue this further.

8. As for Mr Howard's letter, this is the latest in a number of difficulties with DOE about estimates of this sort. In this case, Mr Howard told Sir George Young in the House that the effect of the recent Budget tax changes would be to reduce the ratio from 16 to 15. Quite apart from the unnecessary precision in these figures, it seems extraordinary that Mr Howard did not realise that there might be some Treasury sensitivity over such an estimate of the effect of the Budget on the richest and poorest households. He was answering Questions before the start of the second day's Budget debate. DOE officials had assured us that morning that no such figures would be quoted publicly. Fortunately, the figuring does not seem to have picked up in the Budget context. Any assessment of the effect of the Budget should ideally allow for behaviour responses, which would tend to offset at least partially any reduction due to the cuts in basic and higher rates. We would certainly not wish to see any estimate given in public at this stage, beyond saying that any effect is likely to be small.

9. It is primarily for Mr Howard to decide whether there was anything he said to Sir George Young that calls for clarification in a letter. If, however, he feels it necessary to write, the draft attached to his letter to the Financial Secretary seems acceptable apart from the reference in the third paragraph to the fact that "the ratio is unlikely to fall below about 15:1 as a result of the recent Budget". Our view is that this is incorrect. Instead, he might say simply that the ratio is "unlikely to change greatly".

10. The draft letter attached also refers to the overall ratio, which DOE now seem to accept should be referred to as "about 15", to avoid undue precision.

11. This advice has been agreed with FP and ETS.

*Robin Fellgett*

R FELLGETT

**DRAFT LETTER FOR THE CHIEF SECRETARY'S SIGNATURE**

To: Minister for Local Government

**THE COMMUNITY CHARGE AND THE BUDGET**

Thank you for your letter dated 28 March to Norman Lamont. I have also seen the No.10 remit of 13 April, which our departments are discussing.

① 2. It is unfortunate that you were not aware of the extent of Treasury sensitivity about estimates of this sort before you gave your answer to George Young before the second day of the Budget debate. The Budget tax changes provoked a good deal of comment about their relative effect on the richest and poorest people; and I understand that my officials had been assured by yours that no estimates would be made of the effect of Budget tax changes unless they had been carefully checked and cleared first with the Treasury. Fortunately, however, the figures were not picked up in the Budget debate.

3. It is of course for you to judge whether there was anything you said to George Young which calls for further clarification in a letter. If you do write, I have no objection to the draft attached to your letter subject to changing "fall below about

15:1" to "change greatly" in the third paragraph. On recent tax and grant arrangements, if the Community Charge system had been in operation the ratio would quite likely have been close to 15, but it could have been less.

4. There are inevitably considerable uncertainties about such estimates. Other bases for the calculation could well produce different numbers, and of course the precise ratio is likely to change over time. As my officials discussed with yours some time ago, and have clarified again following the No.10 remit, it therefore seems best to talk about a broad ratio of "about 15" in any public discussion.

5. I see from the draft that you have a Written PQ on this subject, and no doubt further enquiries may be made of you. I should be grateful if your officials could clear any such answers, and any form of words used in other contexts, with mine if they concern in any way the Budget or national taxation generally.

[J.M]

*mp*

*Ch/ Robert has had a go at sorting this out  
(a) and (b) are behind*

FROM: ROBERT CULPIN  
DATE: 15 April 1988

CHANCELLOR

*-but (b) was not cleared with us, and so  
I have agreed with Paul Gray that he will not  
show it to PM this wk-end [none of this will  
stop her or DoE using this statistic, and if we*

WHO PAYS FOR LOCAL GOVERNMENT

*are going to produce a sorting out  
note, it might as well be one agreed  
with us.] Shall I minute*

I think I should give you a note to go with

- (a) *PS/CST or Paul Gray along lines of RC's para 11? Or leave officials*  
a submission from Robin Fellgett to the Chief Secretary on the Community Charge and the Budget; *to pursue agreed note for No 10?*  
and
- (b) a letter from Michael Howard's office to Paul Gray on much the same subject. *mpw*

I have not seen either as I dictate this; but both should reach your weekend box. *15/4*

**Background**

2. As you know, the DOE want to make the point that, even after the Community Charge is introduced, the rich will still pay more for local government than the poor. That is plainly true: much of local government will be financed from general taxation, and the rich pay more tax than the poor.

3. They have chosen to illustrate this by saying that the top 10 per cent of households will pay x per cent more than the bottom 10 per cent. I have been trying to get a grip on x.

*1 suggest - PS  
hnt (Paul Gray) from  
my office) make (with Gray)  
explanatory pts (i) & (ii)  
or Para 11, but note  
bottom etc (iii).*

4. They first put it at 20 in a Press Notice. They subsequently agreed with LG to stick with something vaguer - "about 15". But they keep reverting to a spurious precision. Mr Howard recently said in the Commons that x was 16 before the Budget, but will be 15 after it.

#### Latest statements

5. The Prime Minister said in the House on Thursday that, under the Community Charge, "10 per cent of households with the highest income will pay 15 times as much towards the cost of local services as the 10 per cent of households with the lowest incomes" (Col 341).

6. I understand Mr Ridley used much the same formula in a letter yesterday to Mr Mates.

#### Facts

7. The facts are these.

- (a) We could probably defend a figure of broadly 15, on some definitions, essentially on 1985 data, and rounding to the nearest 5.
- (b) We are pretty confident that the Budget is unlikely to make a huge difference to the statistic, whatever it is. It is unlikely to alter it by more than, say, 1.

#### However:

- (c) Our central estimate would probably be a bit below 15.
- (d) It is quite possible that, after the Budget, "broadly 15" might have to encompass (say) 12. Some might call that broadly 10.

(e) The statistic has, in the past, changed from year to year. It is certainly not a constant.

(f) No one has attempted to extrapolate the data beyond 1985, or just possibly (in one DOE case) 1986.

8. So even if the DOE's arithmetic is right, all it really tells us is that, if the Community Charge had been in force in 1985, the top 10 per cent would then have paid about 15 times more for local government than the bottom 10 per cent. Obviously that is not the same as saying that the top 10 per cent will pay (without qualification) 15 times more than the bottom 10 per cent when the Community Charge comes in, which is what the Prime Minister claimed in the House.

9. The plain fact is that we do not know what the true statistic is now, still less what it will be when the Budget changes come through, still less when the Community Charge is introduced.

#### What is to be done?

10. Does this matter? It is manifestly irritating: the statistic turns largely on who pays the taxes, which is for us to say, not the DOE. And the last thing we want is anything which could be construed to constrain policy on the distribution of the tax burden at the end of the decade. But I doubt if this is worth a huge row.

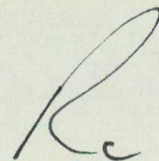
- The basic point that the rich pay more is clearly right and needs to be made.
- About 15 times more is probably not far out, as a broad order of magnitude.
- So long as some reasonable justification can be

produced, I doubt if anyone is going to make a big deal out of whether the number is really 13.6 or 14.2 or whatever.

- My best guess is that, rounded to the nearest 5, the statistic is unlikely to drop below about 10 - though I certainly don't know that.

11. However, I think you should send out three very firm instructions, to reinforce the message in the Fellgett submission. These might be addressed to the Chief Secretary's office, since the submission will be addressed to him; or they might be worth a letter to Paul Gray, depending on what the letter from Mr Howard's office says. (I can't judge that until I see it. It is supposed to be cleared with us, but has not arrived by early evening.) The main points are:

- (i) It is essential that people stick to a broad order of magnitude - about/around/roughly/ of the order of 15 - and do not pretend to a spurious accuracy.
- (ii) No one should say more about the Budget than, at the most, that it is unlikely to make a substantial difference to this very broad order of magnitude.
- (iii) It would be much better to say that, if the Community Charge had been in force in the recent past, the rich would have paid about x times more than the poor than to assert (without evidence) that they will pay that when the Community Charge is introduced.



ROBERT CULPIN

not cleared,  
not shown  
to PM

Howard letter  
unsatisfactory  
on this pt  
(see x on its  
p3)



cc A Tyrie

Chenaker

18/4/88.

1. Too late to copy and circulate.
2. Welcome back
3. I think I am rickening for a term. Given the senior citizens have to cosset themselves, it is just possible that I will let make prayers tomorrow.
4. Do you think Nick Ridley thought through it before asserting that the Lords could not tamper with the Community Charge because it is a tax? We spent the seventies trying to prove that rates should be included in the computation of the tax burden. In the eighties we have been trying to prove that rates should not be included as part of the tax burden. Now they have got in under an alias.

PJC  
Tuesday 19/4/88

# New leak rocks Downing Street

by Charles Reiss  
Political Editor

A NEW leak from Number Ten Downing Street, the most sensational yet in the recent embarrassing series, set alarm bells ringing in Whitehall today.

Labour produced copies of a minute, apparently genuine, from Mrs Thatcher's private secretary Paul Gray.

The document gives a detailed account of the meeting of senior ministers, chaired by Mrs Thatcher, at which it was decided to make a concession to the Tory rebels over poll tax.

It describes Mrs Thatcher, Chancellor Nigel Lawson, Environment Secretary Nicholas Ridley and Leader of the Commons John Wakeham admitting that the issue was now "a focus for concern" among their own back-bench MPs.

The group agreed "that some change to the rebate arrangements should be introduced" to help the worst off.

They then went on to discuss the timing of the concession which would need "careful thought".

The document says they agreed that ministers should avoid giving precise details until today's all important debate.

"But it would be desirable, possibly on April 14, to give some indication to back-benchers that a change to the rebate arrangements would be made".

Mr Ridley duly made just such an announcement last week.

The document was released by La-

bour's Shadow Health Secretary Robin Cook, evidently timed to create maximum embarrassment on the eve of tonight's vote when up to 40 Tories are threatening to rebel against the poll tax.

But it is the fact of the leak that is likely to alarm and anger ministers most.

Mr Cook erased the headings and other details including the date of the new document. But it appears to refer to a meeting at Downing Street only last week.

Copies went to the Environment Department, the Treasury and to the offices of Mr Wakeham and the Chief Whip Mr David Waddington.

For good measure Mr Cook also revealed a letter to the unfortunate Mr Gray, apparently from a private secretary in the Environment Department.

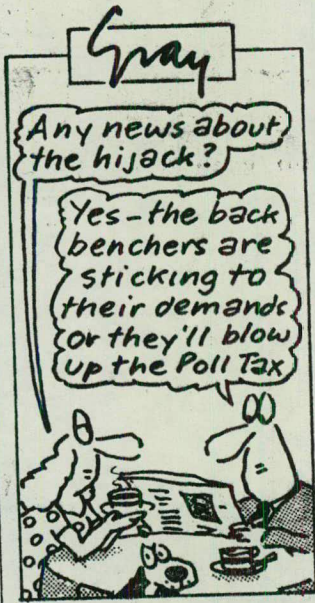
It speaks of Mr Ridley's problems with the housing benefit and poll tax and says "he is coming under increasing pressure in the local government Finance Bill where the issue is beginning to be understood by a number of back-benchers."

The incident is the second of its kind involving Mr Gray, one of Mrs Thatcher's private secretaries dealing with home affairs.

The first, in March, was a minute from Mr Gray to his opposite number in the Education Department and was used by Labour to embarrass Mr Kenneth Baker over his Education Reform Bill.

A few weeks later there was a further leak of a private secretary's letter in the Scottish Education Department.

A Whitehall mole hunt has already been launched



## Poisoning scare at top hotel

MORE than 50 people have been taken ill at the Gatwick Hilton after an outbreak of salmonella poisoning.

One member of staff has been sent to hospital, 50 others were sent home and two hotel guests have been found to be suffering from salmonella poisoning.

A woman kitchen worker at the hotel who was taken to hospital was thought to be vulnerable to the disease because she was on a strict slimming diet.

Local health officers tested 275 of the hotel's 360 staff and found 50 were carrying the infection.

They have not formally identified the source, although they are testing one specific food source from outside the hotel.

A spokeswoman for the Hilton confirmed that more than 100 of the hotel's staff

# Filth is blamed for King's Cross disaster

by Gervase Webb

A FILTHY escalator and lack of staff training were the two main causes of the King's Cross fire, the disaster inquiry heard today.

Charles Pugh, representing the victims and bereaved, said one of the two principal causes was the build-up of "muck" on the escalator which, he said, was as flammable as household firelighters.

And of the other cause he said: "For the purposes of dealing with fire emergencies, the vast majority of staff

Mr Pugh added that for the Underground management to admit the problem would show "a statesman-like approach and one that shows a little humility."

He said the Underground management should come clean about poor standards of staff training and management to save time at the inquiry.

"We consider that much time could and would be saved if London Underground Ltd were publicly to acknowledge that at all levels

Mr Pugh called for a radical shake-up of staff training in the light of King's Cross.

He said the inquiry had heard of 'a disturbing state of affairs' on the night of the fire where station staff had gone off for unauthorised meal breaks or simply not been at their posts, and of how the fire had been unfought for 15 minutes.

Station managers, he said, should have more authority, comparing the situation at the time of King's Cross to one where "there was the responsibility of the captain of the ship with the power of the cabin boy. We would sug-

lators and concourses to get to know the risks facing passengers, saying: "This should become part of the management duty of all station staff. Such personnel would then be more likely to be effective in a fire emergency."

Mr Pugh also called for an assessment of the fire risks at all stations to be kept so staff, emergency services and the public could be aware of the dangers.

And he called for a speeding-up of the Underground's replacement programme for wooden escalators and more frequent inspection.

Alan Cooper, QC, for the National Union of Railway-

learn the lessons of King's Cross, but "if plans for future cuts in staff are anything to go by, they will not learn the lessons," he said. He added: "It has become clear to the NUR that London Underground's concern for the safety of staff and passengers has been allowed to be sidetracked by a preoccupation with cost-effectiveness rather than safety-effectiveness"

John Hendy, QC, for the Association of London Authorities, said that there was only one railway safety inspector covering the whole of London Underground, BR Network South-East, and the

Ch: our copies behind

prop

upon

CONFIDENTIAL



FROM: JILL RUTTER  
DATE: 18 April 1988

MR POTTER

CC:  
Principal Private Secretary  
Sir Peter Middleton  
Mr Anson  
Mr H Phillips  
Mrs Case  
Mr Hawtin  
Mr Perfect  
Mr Call

**LA CAPITAL CONTROLS**

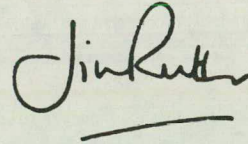
At the end of this morning's meeting on Education Support Grants, Mr Ridley mentioned a problem that was concerning him. In the restriction on lease back deals he had announced which was to be contained in an amendment to the Local Government Finance Bill the Government proposed to stop barter arrangements. Since that announcement he had discovered that the scale of barter was colossal and that a lot of "good Tory councils" were engaged in such deals to allow them to trade and develop property by swapping assets. He believed it would be necessary to allow deals currently in the pipeline to go through. He was concerned that this, combined with the new capital control system, was beginning to look very harsh. Half of local authority capital spending seemed to be being financed through loopholes and half through officials' means. Stopping the loopholes would result in a major cut-back in the effective spend.

2 He noted that the amendment and the regulations ending leaseback would have to be debated in due course. The amendment would be debated next Monday. He thought that it was a bad time to have another row with local government.

CONFIDENTIAL

3 The Chief Secretary said he thought that officials should have a look at this.

4 Mr Ridley did not make any specific proposal on what should be done nor did he suggest that he wanted to amend the Local Government Finance Bill. Nonetheless the Chief Secretary would be grateful if you could pursue with DOE officials.

A handwritten signature in cursive script, appearing to read "Jill Rutter", with a horizontal line underneath the name.

JILL RUTTER  
Private Secretary



# THE TREASURY SOLICITOR

Queen Anne's Chambers  
28 Broadway London SW1H 9JS

Telephones Direct Line 01-210 3049  
Switchboard 01-210 3000  
Telex 917564 GTN 210  
Fax No. 01-222 6006

M L Saunders Esq  
Legal Secretary  
Law Officers' Department  
Attorney General's Chambers  
Royal Courts of Justice  
Strand  
London WC2

Please quote  
A8875/JLW

Your reference

Date  
18th April 1988

*Dear Michael,*

## TREATMENT OF THE COMMUNITY CHARGE IN THE RPI: INDEXED GILTS

We discussed last week the Chancellor's request for the Law Officers' advice on the implications for indexed gilts of the transition from rates to the Community Charge. I enclose the relevant Instructions.

I understand that the Attorney General has asked that John Mummery should be involved in this matter and I am therefore copying this letter and the Instructions to him. Perhaps you would let me know if John Mummery and/or the Attorney General would like a meeting. The Treasury would be very grateful if the advice could be available in time for the Chancellor to consider it at an internal meeting on 4th May but this may of course be impractical.

A copy of this letter and the Instructions also goes to Michael Scholar at the Treasury.

*Yours ever,*

*M.L.S.*

Miss J L Wheldon

*(This seems to lead over backwards to present the other side of the case)*

*Wheldon  
Saunders  
16/4*

CONFIDENTIAL  
MARKET SENSITIVE

RETAIL PRICES INDEX AND COMMUNITY CHARGE:  
INDEX-LINKED GILTS

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INSTRUCTIONS

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- Enclosure 1: 2 Per cent Index-Linked Treasury Stock 1996 Prospectus
- Enclosure 2: Retail Prices Index - Current Composition
- Enclosure 3: Local Government Finance Bill
- Enclosure 4: "Method of Construction and Calculation of the Retail Prices Index"
- Enclosure 5: "Methodological Issues Affecting the Retail Prices Index"
- Enclosure 6: CSO draft paper: "Definition and Classification of Taxes in the United Kingdom National Accounts: Treatment of Proposed Community Charge"
- Enclosure 7: D/Emp draft paper: "Treatment of Rates and the Community Charge in the RPI"
- Enclosure 8: Treasury note "The treatment of LA rates and the CC"

1. The Law Officers and Treasury Counsel are asked to advise on the implications under the prospectuses for index-linked gilts of the change from rates to the community charge. All such prospectuses contain a provision (paragraph 23 of Enclosure 1) which states that "if any change should be made to the coverage or to the basic calculation of the Index which, in the opinion of the Bank of

England, constitutes a fundamental change in the Index which would be materially detrimental to the interests of stockholders" the Treasury must give stockholders the option of redemption before the revised index becomes effective for the purposes of the prospectus. Domestic rates have been included in the RPI from its inception under the heading of housing (Enclosure 2). The treatment of the community charge in the RPI has not yet been determined but the options now being considered raise the question of whether they involve a change in the coverage or basic calculation of the Index.

2. There is no comprehensive statutory definition of rates but a useful description is to be found in section 519(4) of the Income and Corporation Taxes Act 1988. The community charge is established under the Local Government Finance Bill (Enclosure 3) currently going through Parliament. The scheme of the proposed legislation is that domestic rates should be replaced by three types of community charge: the personal community charge, payable by those who have their sole or main residence in the area of the relevant authority; the standard community charge, payable on second homes; and the collective community charge, payable by landlords of premises used by individuals as their sole or main residence for short periods. These charges differ from domestic rates in that they are flat rate per capita taxes rather than property taxes levied by reference to the value of the property in question. The charges are however similar to domestic rates in that the proceeds are applicable for public local purposes and that different local authorities can set the charge at different levels.

3. Referring to income tax and certain other payments that are excluded from the RPI the 1956 Advisory Committee (Paragraph 24 of Enclosure 5) said "most expenditure [of this type] is excluded from the weighting pattern because of the variable and non-measurable nature of the services acquired in return for the payments made and because of the difficulty or impossibility of identifying a "unit" the price of which could be measured from date to date (see para 7 of Enclosure 4)". It has in the past been suggested that rates should be excluded from the RPI (para 41 of Enclosure 5) as they are a form of local taxation, rather than a direct payment for services provided. It has been concluded however that as the taxation is on the occupation of property, it is appropriate to include it as a housing cost, just as other expenditure taxes are included as a cost of the product or service to which they relate. Rates are therefore included in the RPI as are VAT, excise duty <sup>TV licences</sup> and vehicles <sup>excise duty</sup> tax (which, like rates, is separately listed in Enclosure 2) and the principle was reaffirmed in 1987.

4. The community charge is not related to the consumption of a specific service - unlike rates which are assessed on the rental value of a particular property - and it should, according to the principles outlined above, be excluded from the RPI. The Central Statistical Office are for the same reasons minded not to classify the community charge as a tax on expenditure, which is how they classify rates, and are considering drawing a new distinction in the national accounts between direct taxes, which will include the community charge, and indirect taxes, which would include rates (Enclosure 6).



5. Omission of the community charge from the RPI would however raise serious problems. Not only has the Government gone to some pains to present the community charge as a payment for services, rather than a poll tax, but omission of the community charge from the RPI would mean that the level of the RPI was significantly reduced from what it would otherwise have been. The Department of Employment have drafted a paper (Enclosure 7) in which they set out the various issues and suggest three main options as to how the community charge should be treated in the RPI.

Option A substitutes the community charge for rates. It is estimated that this would have the effect of raising the level of the RPI in April 1990, when the community charge takes effect in most of England and Wales, by about 0.25%. Thereafter, the RPI is expected to increase faster under this option than under Options B or C or indeed than it would have increased had the system of rates remained in place.

Option B would omit the community charge from the RPI but in such a way as to avoid any major discontinuity. Thereafter the RPI would be expected to rise more slowly, perhaps by 0.1 to 0.2% per annum, than under option A. The change would also probably be disadvantageous in comparison with the present rating system.

Option C would not include the community charge in the RPI and would reduce rates to near zero in April 1990. This would lead to a step reduction of about 4% of the RPI in 1990. Thereafter, as with Option B, the RPI would be expected to grow more slowly than under Option A or under the present rating system.

6. As indicated in paragraph 3 of these Instructions the purist choice among these options from the statisticians' point of view would be Option C. It would be irrelevant,, according to this argument, that Option C involves the loss of a component of the Index and thereby significantly reduces its level. Such a change would not be a change of coverage within the meaning of the indexed gilt prospectus, despite its admittedly significant effect on stockholders, any more than the abolition of VAT or VED and the substitution of higher rates of income tax, or the disappearance from the index of some product no longer bought by households, would involve a change in coverage. Taxes, it would be argued, have only been included in the RPI to the extent that they represent part of the price of products and services covered. Rates are included in the RPI as a cost of housing, not as the cost of local government services, and since the community charge is not levied by reference to the value of the property or the consumption of specific services which can be measured it can have no place in the Index.
7. According to this view, option A, unlike Option C, involves a change in coverage of the RPI since a type of expenditure would now be brought in which previously had been excluded under the principles referred to at the beginning of paragraph 3 of these Instructions. However, since the change would be expected to be beneficial to stockholders in comparison either with Options B or C the redemption clause in the indexed prospectus would not be triggered.
8. Option B, despite omitting the community charge from the Index, would according to this view also involve a change in coverage or basic calculation since it necessarily involves either taking rates out of the RPI at a time when they are still being paid, or compensating for their removal from the index by adjusting

their weighting within the index at a different time from usual (see Enclosure 8). But, if the analysis above is correct, although Option B constitutes a change in coverage, it could not be held to be detrimental to stockholders, since they would be better off under this Option than under Option C, which is the proper point of comparison.

9. Against this it might be represented that Option B was indeed a change detrimental to stockholders, because they would be worse off than they would be under Option A, or than under continuation of the existing system of rates. But this argument does not appear to be well founded: Option A is an irrelevant point of comparison, since it represents neither the status quo nor the new situation on the existing rules. Nor is there any reason why the proper point of comparison should be a hypothetical and artificial projection of what the RPI would have been had the rating system continued.
10. It is possible that a version of Option B may be devised (see paragraph (2) of Enclosure 8) which could be represented as involving only minor and technical changes to the method of calculation, and which might be held to be within the spirit of the present method of calculation. If so, it might be that the Bank would be able to conclude that, although a change had been made, it did not represent a fundamental change. Since this is at the moment hypothetical the Law Officers and Treasury Counsel are asked to ignore the possibility for the purposes of these Instructions, subject to the following point. If a change can be devised which is not "fundamental" from the statistical point of view it will still be "materially detrimental" to stockholders if compared with Option A or an index based on the continuation of rates. This therefore raises the question, which is of wider interest to the Treasury and on which they would

welcome advice, as to whether a change which is materially detrimental to stockholders can be anything other than fundamental for the purposes of the prospectus.., If the answer to this question is that it cannot, the word "fundamental" in the prospectus seems redundant: on the other hand it appears difficult to argue that a change which is materially detrimental is not fundamental.

11. There is of course a way of looking at the options under consideration which is very different from that advanced in paragraphs 6-8. It could be argued that, whatever the statistical justification for the inclusion of rates in the RPI, its effect is to include local government taxes or, to put it another way, a substantial proportion of the cost of public local services in the coverage of the Index. The abolition of rates will not mean that local government taxes are abolished or that public local services cease to be financed from such taxes. If the community charge is omitted from the Index, so this argument runs, there is a clear change in its coverage, which is evidenced by the change in the projected level of the Index. According to this view, both Options C and B would mean that the first precondition of the redemption provision in indexed gilt prospectuses was satisfied and that the only question was whether, in the Bank of England's view, this would have a detrimental effect on stockholders. There is little doubt that the Bank of England would conclude that either option would indeed have such a detrimental effect. Indeed it is also thought likely that the Bank would adopt the view expressed in this paragraph and conclude that both Option B and Option C constituted a change in coverage or basic calculation. Subject to the advice of the Law Officers and Treasury Counsel, it is not however thought that their view on this, as opposed to their view on whether the change is fundamental or materially detrimental to

stockholders, is strictly relevant to the prospectus. The test of whether or not there has been a change in coverage or calculation appears to be objective not subjective.

12. The questions on which the advice of the Law Officers and Treasury Counsel is sought are therefore:
- (1) Can the Treasury safely argue (a) that Option C does not involve any change in the coverage or basic calculation of the RPI, (b) that the prospectus does not allow a plaintiff to argue that this is a matter on which the Bank of England's opinion is to be given and (c) that Option C does not therefore trigger the option of redemption?
  - (2) Would Option B also avoid triggering the gilts redemption provision on the basis that, although it constitutes a relevant change within the meaning of the prospectus, the detriment to stockholders would have to be compared with a situation (ie Option C and not Option A) which the Law Officers and Treasury Counsel are informed would be regarded by the Bank of England as more detrimental still?
  - (3) Irrespective of the answer to (2) and the facts of this case, could there theoretically be a change in the coverage or calculation of the RPI which was materially detrimental to stockholders but not "fundamental" for the purposes of the redemption clause?

13. The Law Officers and Treasury Counsel will appreciate that if option C or B is followed and there is subsequently a successful challenge to the decision not to offer redemption, the consequences could be severe. Although there is a 7 months time lag under the prospectus (paragraph 15 of Enclosure 1) before a change in the Index takes effect for the purposes of the prospectus, a decision on how the Index should be calculated would in practice be irrevocable once Index figures based on this decision had been generated. The relevant index for calculation is the one that has been published (paragraph 5 of Enclosure 2). The Government could not therefore reverse a decision on how the Index was to be calculated in the light of proceedings during the 7 month period. Moreover it is thought impractical, in view of the uncertainty and disruption which would be caused in the gilt-eded market, for the court to be asked to make a declaration about the implications for the prospectus of the community charge in advance of any RPI figures being generated under the new system, even if such proceedings were theoretically possible. In other words, the Government would have to make a once and for all choice of option B or C and accept any associated risk of the redemption of index-linked gilts. Since this redemption would cost about £2.8 billion (as measured by the difference between the redemption cost and current market value of the stock) Ministers will, if advised by the Law Officers and Treasury Counsel that Options B and C do not require redemption, be anxious to know the sort of odds which would apply if the matter went to court. The difficulty of predicting the outcome of litigation, particularly in the absence of the evidence which would then be available (including a report from the RPI Advisory Committee), is of course well understood and it is accepted that any estimate would need to be revised in the light of such further information.



DEPARTMENT OF THE TREASURY

Washington

*pm*

Ch

Figures for LA capital in table below

Main point to watch is that gross provision is increased by  $\$0.6$  bn in 1988-89 a previous baseline. But still  $\$0.2$  billion below estimated out-turn for 1987-88.

ATA

FF26 LOCAL AUTHORITY CAPITAL EXPENDITURE

Detailed questions to relevant Departments.

Secretaries of State for Environment, Transport, Health and Social Security and Education will issue Press Notices on 3 November.

[See also Public expenditure: 1987-88 (E1), Transport (Brief FF9), Housing (FF10), Other environmental services (FF11), Home Office (FF12), Education and Science (FF14) and Health and Personal Social Services (FF16)]

Factual

(i) <u>Provision (GB)**</u>	1987-88	1988-89	1989-90	£ billion 1990-91
<u>Survey changes</u>				
gross	not app	+0.6	+0.3	not app
receipts	not app	+0.6	+0.6	not app
net	not app	0.0	-0.3	not app
<u>Autumn Statement</u>				
gross	7.1 *	6.9	6.8	6.7
receipts	3.4 *	2.9	2.9	2.9
net	3.7 *	4.0	3.9	3.9

\* estimated outturn

\*\* includes LA payments to public corporations

(ii) Main sources of spending power (allocations and receipts)

	1986-87	£ million 1987-88	1988-89	percentage change 1988-89 on 1987-88
<u>England DOE/LA1<sup>(1)</sup></u>				
<u>allocations</u>				
Housing	1,465	1,366	1,290	-6
Transport	618	586 (2)	629 (2)	+7
Education	297	297	369	+24
Personal Social Services	73	61	71	+16
Other	295	274	261	-5
Total allocations	2,748	2,584	2,621	+1
Spending power from receipts	2,600	2,800	3,600	+28
<u>Wales - allocations</u>	323	369	326 (3)	-12 (3)

(1) Covers all LA capital spending in England except for law and order spending. (See FF12.)

(2) Excludes £55 million in 1987-88 and £5.2 million in 1988-89 transferred from British Rail's external financing limit (EFL) for Passenger Transport Executive's rolling stock (so cost of financing associated debt reflected in grant payable to relevant local authorities (LAs)).

(3) Subject to Secretary of State for Wales' discretion on allocating resources within his block.





FROM: JILL RUTTER

DATE: 19 April 1988

MR H PHILLIPS

*Handwritten notes in red ink:*  
What we  
have agreed to do  
is not X  
when system is in place?

- cc:
- PS/Chancellor
- Sir Peter Middleton
- Mr Anson
- Mr Hawtin
- Mr Turnbull
- Mrs Case
- Miss Peirson
- Mr Gieve
- Mr Potter
- Mr Fellgett
- Mr Burns
- Mr Call

*Handwritten notes in black ink:*  
Ch  
Yes indeed. I'm  
not sure exactly  
what CST's  
objectives are  
(neither is Jill).  
I think he felt he  
wanted more time  
to consider it, hence  
request for submission  
(I think it's a good  
idea)

PS/CST  
PHILLIPS  
19/4

1989-90 RATE SUPPORT GRANT SETTLEMENT FOR ENGLAND

The Chief Secretary held a meeting with you, Mr Turnbull, Mr Potter and Mr Fellgett to discuss your minute of 8 April covering a minute of 7 April by Mr Fellgett.

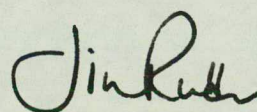
2 The Chief Secretary said he did not expect this to be an easy RSG negotiation for the Treasury. He did not see any easy way of moving the grant percentage even with the polytechnic shift which would no doubt be treated as an automatic reduction on both sides of the account by colleagues. He thought there was a case for including a "concession" in any Treasury paragraph or paper for the initial E(LA) discussion of not pressing frozen grant or targets and penalties. He thought we should deploy the argument on the polytechnic transfer which was marginally helpful. He agreed that he should speak to Mr Ridley in advance of a formal E(LA) discussion. He would aim to do this in early May. He also wished to get into contact with Mr Parkinson. At some stage the Prime Minister would also have to be informed.

*Handwritten notes in red ink:*  
It is. But ~~not~~ saw  
CST a bit for me, not  
copies, ~~not~~ but  
our ~~idea~~ etc -  
m.

3 After some discussion it was agreed that it would be best to talk to Mr Parkinson, then talk to Mr Ridley and write to Mr Parkinson at about the same time as that meeting. The matter should be raised with the Prime Minister either at the PES discussion envisaged by Mr Turnbull for May or if that proved impossible the Chancellor might be asked to raise it at one of his bilaterals.

4 The Chief Secretary said he would find it helpful to have a matrix of provision, cash grant and grant percentages. He noted that arguments to cut the grant percentage last year had fallen on relatively deaf ears.

X | 5 Mr Potter mentioned the case officials saw for trying to settle 3 years of forward grant. The Chief Secretary said he saw substantial downsides in this. He asked you to arrange for a minute to be produced on this proposal.



JILL RUTTER

Private Secretary



FROM: MOIRA WALLACE  
DATE: 20 APRIL 1988

MR FELLGETT

cc PS/Chief Secretary  
Sir P Middleton  
Mr Anson  
Mr Phillips  
Mr Hawtin  
Mr Potter  
Mr Dyer

NNDR: CHANCELLOR'S CONVERSATION WITH MR RIDLEY

The Chancellor spoke to Mr Ridley on the phone this afternoon. Mr Ridley said he wanted to raise a small point on the Local Government Finance Bill, which officials had been unable to resolve. He understood there were constitutional/Parliamentary difficulties with the proposed amendments giving the Chancellor the power to uprate the NNDR by less than the RPI. Things would be much simpler if the power were in Mr Ridley's name, but Treasury officials had not been willing to concede this.

2. The Chancellor said he was not aware of a problem in this area, and he reserved his position. He said that he would look into the matter, and let Mr Ridley have an answer as soon as possible. Mr Ridley said he would need an answer by tomorrow afternoon, when the relevant amendments were to be taken.

3. As I mentioned to you, the Chancellor would like a note on this as soon as possible. His preliminary view, which he did not put to Mr Ridley, was that, if there is a genuine difficulty with the powers being in the Chancellor's name, then one option would be for these powers to be <sup>made</sup> subject to the Chancellor's approval"

*Mpw.*

MOIRA WALLACE

Local Government Finance Bill *continued*

Mr John Heddle

226

Page 27, line 29 [Clause 47], at end insert—

'(8) The regulations shall make provision for a person being the occupier or deemed occupier of a hereditament to have a right of appeal in relation to an assessment in each of, or in any combination of, the following circumstances, namely:

- (a) during the currency of a valuation list at any time where there is a change of the occupier of the hereditament, or,
- (b) during the currency of a valuation list at any time following a material change of circumstances affecting the hereditament, or,
- (c) in any event not less than once on a general ground in the period of five years commencing with the first date of coming into force of a new rating list or lists, or,
- (d) upon the making of any change to the entry affecting that hereditament in the relevant rating list or lists, including the deletion from a list of an entry or the inclusion within a list of a new or amended entry,

and may provide for additional rights of appeal or challenge in relation to an assessment, or liability based thereupon, arising under this Act.'

Mr Secretary Ridley

11

Page 94, line 22, [Schedule 5], leave out 'less than 51p' and insert '50p or less'.

Schedule 6 4<sup>th</sup> Day (21/4) Clause 13b 5<sup>th</sup> Day (25/4)

Mr Secretary Ridley

12

Page 95, line 34, [Schedule 5], leave out 'less than 51p' and insert '50p or less'.

Mr Secretary Ridley

13

Page 95, line 47, [Schedule 6], leave out 'one decimal place' and insert 'three decimal places'.

Dr John Cunningham  
Mr Jeff Rooker  
Mr William O'Brien  
Mr Allen McKay

168

Page 96, line 16 [Schedule 6], leave out 'retail prices' and insert 'prescribed'.

Local Government Finance Bill *continued*

Mr Secretary Ridley

Page 96, line 17 [*Schedule 6*], at end add ' ; but if the Treasury so provide by order in relation to the year concerned, B is a figure which is less than that index and which is specified in (or calculated in a manner specified in) the order.' 179

Dr John Cunningham  
Mr Jeff Rooker  
Mr William O'Brien  
Mr Allen McKay

Page 96, line 18 [*Schedule 6*], leave out 'retail prices' and insert 'prescribed'. 169

Dr John Cunningham  
Mr Jeff Rooker  
Mr William O'Brien  
Mr Allen McKay

Page 96, line 32 [*Schedule 6*], leave out from 'the' to end of line 37 and insert 'prescribed index are references to an index maintained by the Secretary of State to reflect the movement of costs incurred by local government'. 170

Mr Secretary Ridley

Page 96, line 39 [*Schedule 6*], leave out from 'as' to end of line 40 and insert 'he determines'. 180

Mr Secretary Ridley

Page 96, line 42, [*Schedule 6*], leave out from beginning of line to end of line 46 and insert 'three decimal places only— 14

(a) adding one thousandth where (apart from this sub-paragraph) there would be more than five ten-thousandths, and

(b) ignoring the ten-thousandths where (apart from this sub-paragraph) there would be five, or less than five, ten-thousandths.'

Mr Secretary Ridley

Page 96, line 46 [*Schedule 6*], at end insert— 181

'(10) The power to make an order under sub-paragraph (3) above shall be exercisable by statutory instrument.

(11) An order under sub-paragraph (3) above in its application to a particular financial year (including an order amending or revoking another) shall not be effective unless it is approved by resolution of the House of Commons before the approval by that House of the revenue support grant report for the year or before 1 March in the preceding financial year (whichever is earlier).'

Local Government Finance Bill *continued*

Mr Secretary Ridley

Page 97, line 2 [*Schedule 6*], after 'contain', insert '(a)'.

182

Mr Secretary Ridley

Page 97, line 3 [*Schedule 6*], at end insert ', and

183

(b) the date determined by him under paragraph 5(8) above for the purpose of making the estimates.

(3) A calculation under sub-paragraph (1) above is invalid unless one or both of the following conditions is fulfilled—

(a) it is made after the revenue support grant report for the year has been approved by resolution of the House of Commons;

(b) it is made on or after 1 March in the preceding financial year.

(4) A calculation under sub-paragraph (1) above is invalid if made at a time when an order under paragraph 5(3) above which is effective in relation to the year has not come into force.'

Dr John Cunningham  
Mr Jeff Rooker  
Mr William O'Brien  
Mr Allen McKay

Page 97, line 5 [*Schedule 6*], leave out paragraphs 7 and 8.

172

Mr Secretary Ridley

Page 97, line 11, [*Schedule 6*], leave out 'one decimal place' and insert 'three decimal places'.

15

Mr Secretary Ridley

Page 97, line 23 [*Schedule 6*], at end insert—

184

'(3A) An order may be made under paragraph 5(3) above in relation to a financial year beginning in or after 1991 even if a multiplier is or may be specified for the year under paragraph 7 above.'

Mr Secretary Ridley

Page 97, line 32 [*Schedule 6*], leave out 'one decimal place' and insert 'three decimal places'.

16

Local Government Finance Bill *continued*

Mr Secretary Ridley

Page 97, line 40 [Schedule 6], leave out sub-paragraph (4) and insert— 64

'(4) An order under sub-paragraph (3) above in its application to a particular financial year (including an order amending or revoking another) shall not be effective unless it comes into force before 1 January in the preceding financial year.'

Mr Secretary Ridley

Page 98, line 20 [Schedule 6], leave out 'expiry' and insert 'end'. 72

Dr John Cunningham  
Mr Jeff Rooker  
Mr William O'Brien  
Mr Allen McKay

Page 28, line 15 [Clause 49], leave out 'and 1994' and insert '1994, 1995, 1996, 1997, 1998 and 1999'. 171

Mrs Teresa Gorman

Page 28, line 15 [Clause 49], at end insert— 228

'(5) Any non-PLC business that can prove it is solvent and that its taxable profit is less than £20,000 per annum can claim non-domestic rate abatement by completing a form for the purpose which is counter signed by the business's accountant. The amount of the abatement to be set by the Secretary of State annually.'

Sir Hugh Rossi

★ Page 28, line 15, [Clause 49], at end insert— 270

'(5) Any business not paying Corporation Tax at the higher rate can claim non-domestic rate abatement at a level set by the Secretary of State annually.'

Mr Secretary Ridley

Page 28, line 24 [Clause 51], leave out 'establishment and maintenance of the non-domestic rating pool' and insert 'keeping of non-domestic rating accounts, and for sums to be paid to and by the Secretary of State'. 104

Local Government Finance Bill *continued*

Mr Secretary Ridley

Page 73, line 9 [*Clause 134*], leave out 'pools shall be established and maintained' and insert 'accounts shall be kept'. 108

Sir Brandon Rhys Williams

Page 73, line 32, [*Clause 136*], at end insert 'but no such order or regulations shall restrict, or include any power to restrict, the right of leasehold enfranchisement.'. 8

Mr Secretary Ridley

Page 73, line 33 [*Clause 136*], leave out '(6)' and insert '(7)'. 177

Mr Secretary Rifkind

Page 73, line 38 [*Clause 136*], after first 'above' insert 'or section [*Commencement: Scotland*] below'. 74

Dr John Cunningham  
Mr Jeff Rooker  
Mr William O'Brian  
Mr Allen McKay

Page 73, line 42 [*Clause 136*], after 'Schedule 5', insert 'or Clause 122'. 224

Mr Secretary Ridley

Page 73, line 45 [*Clause 136*], at end insert— 178  
'(7) The power to make an order under paragraph 5 of Schedule 6 below shall be exercisable as there mentioned.'

Mr Secretary Ridley

Page 74 [*Clause 137*], leave out line 13. 32



SECRET

*pay*

*Ch/ Mr Potter has treated this essentially as a political question, which was not my impression of yr talk with Mr Ridley - nor I hope my debrief to Mr P.*

FROM: BARRY H POTTER

DATE: 20 April 1988

CHANCELLOR

cc Chief Secretary  
Sir P Middleton  
Mr Anson  
Mr Phillips  
Mr Hawtin  
Mr Turnbull  
Mr Fellgett  
Mr Cropper

*But the constitutional/legal question is dealt with in para 9 - not an issue, as DoE agree at official level. (I have spoken to Brian Dyer who confirms this)*

LOCAL GOVERNMENT FINANCE BILL: POWER TO UNDER INDEX THE NNDR

*m/pw 20/4*

I understand from your Private Office that Mr Ridley came to see you this afternoon to discuss the power to override the annual indexation of the NNDR poundage. I believe he suggested to you that this power should be placed in his name rather than yours; as I understand it (in advance of seeing your Private Secretary's note) he argued that this was necessary essentially for political reasons.

*not quite what I said, or wrote!*

2. DOE officials have since spoken to us and pressed us to advise you this evening, so that you might contact Mr Ridley later tonight to let him know your views.

Background

3. E(LF) decided and subsequently confirmed last year that the power to override the annual indexation of the NNDR poundage should be placed in your hands. Although no such power was included in the original draft of the Bill, at official level we have negotiated a suitable form of words with DOE officials. Parliamentary Counsel has been difficult and slow on this. He has insisted that the particular form in which the power is expressed (an Order for affirmative resolution) is consistent with the timing and mechanics of laying the revenue support grant report before Parliament for its approval. As a result of this the proposed amendments (like most of the Bill) are a little difficult to understand and have only just been finalised - despite continual pressure from us.

SECRET

4. You should also be aware that DOE officials have always been vigorously opposed to the Treasury having the power - and have made repeated attempts to overturn the original E(LF) decision.

Assessment

5. Mr Ridley is certainly concerned that the amendments add to the complexity of the Bill. But his real worry is that they will be a source of further political controversy during tomorrow's Report Stage debate. His officials have intelligence that the Opposition will attack the proposal for you to override the uprating of the NNDR (and the intention to have NNDR proceeds paid into the Consolidated Fund) as meaning that NNDR is a central government tax. Mr Ridley wishes to avoid what he sees as an unnecessary political controversy.

6. But as we have persuaded DOE officials (and they are now hoping to speak again to Mr Ridley tonight) this controversy is now unavoidable. Only two courses are open: withdraw the amendments (laid down already for debate tomorrow) or debate them. If the amendments are not moved we believe that it would be difficult to lay the new clauses for the first time in the Lords. These amendments deal with financial issues and as a matter of privilege should be dealt with in the Commons. The amendments cannot be lost: that is not consistent with the E(LF) decision; nor public commitments (eg to the CBI on the uprating) nor in the case of the NNDR pool and the Consolidated Fund, with practicality of the policy.

7. In our view, therefore, the amendments have to be debated tomorrow. But Mr Ridley could of course indicate during debate that - in view of Opposition concern - he would change their form in the Lords. This is obviously a question for political judgement. But is there not a serious risk that any such indication, let alone a firm undertaking, would be widely seen as a retreat by the Government in the face of Opposition pressure? (So would withdrawal of <sup>the</sup> amendments.) It would surely be better to stick to a firm commitment that there is no intention to take

SECRET

over the NNDR as a central Government tax. Indeed the Bill specifically hypothecates the tax to the LAs - it would be illegal to use the NNDR proceeds for anything else.

Conclusion

8. I recommend that you advise Mr Ridley he should go ahead with the debate and defend the proposed amendment - in its present form - tomorrow. There seems no practical alternative. But you might wish to leave open the possibility that the form of the power could be changed again in the Lords - if Mr Ridley is able to persuade you of the merits of the case.

9. This is not a legal issue - DOE officials, Parliamentary Counsel and ourselves are satisfied that the proposals in the amendment are workable and should deliver the policy decision taken at E(LF). There are considerable political risks in drawing back from the amendment at this late stage.

Barry H. Potter

BARRY H POTTER

CONFIDENTIAL

PPS pot . 22/76

FROM: R M PERFECT

DATE: 20 April 1988

Not rec'd until 21/4

1. MR POTTER <sup>BHP</sup> 20/4
2. CHIEF SECRETARY

cc PPS ←  
 Sir Peter Middleton  
 Mr Anson  
 Mrs Case  
 Mr Hawtin  
 Mr Turnbull  
 Mr Call

## LA CAPITAL CONTROLS

Mr Ridley spoke to you about barter deals - Jill Rutter's minute of 18 April refers. We have discussed the problem with DOE officials and Mr Ridley will be writing to you.

2. Mr Ridley's announcement of 9 March brought into the LA capital control system: sale and leaseback deals; barter deals; purchases of shares and payments in respect of guarantees. The problems that mainly concern Mr Ridley are arising on barter deals, under which a local authority swaps land or buildings for other land and buildings or services (typically construction work). It is now clear that far more local authorities have been setting up barter deals than DOE realised. So local authorities' ability to obtain new assets (in return for existing assets) has been higher than we realised. Local authorities, and their MPs, do not see why these deals should be stopped.

3. Barter deals are caught by the amendments to the Local Government Finance Bill which are due to be discussed between 7.30 pm and 9.00 pm on Monday 25 April. Regulations, to control short term leases, under the 1980 control system, will be debated between 10.00 and 10.30 pm that evening. Government supporters are likely to be particularly concerned with the first Vote, on the amendments. And in view of the wider problems on local government finance Mr Ridley is anxious to go some way towards meeting their concerns.

## Why control barter deals?

4. DOE want to stop barter deals so that they, and the district auditors, can be sure that local authorities are not selling assets too cheaply. We do not regard this as a very strong case. Treasury

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has not been concerned about deals under which one piece of land is swapped for another. But deals which swap land for services do concern us, because they increase the level of economic activity in the economy in the same way as public spending does. We believe this argument is convincing.

Possible solutions

5. Mr Potter and I have discussed with DOE officials three possible solutions to Mr Ridley's problems. We have expressed a strong preference for option (iii).

i. Drop the proposals. Mr Ridley could drop his proposals to control barter deals. But this would be a defeat for him. And there is a danger that many barter deals will then be arranged before the new capital control system is in place.

ii. Increase spending power from receipts. DOE officials have suggested that the existing restrictions on the use of accumulated and in-year non-housing receipts (known as the prescribed proportion) could be increased from 30 per cent to 40 or even 50 per cent. This is an indirect solution to the problem. DOE hope it would ensure that most local authorities have sufficient spending power to complete the deals that the 9 March statement brought into the control system. We have argued against this approach for two reasons. Firstly, loosening the present control system now will make the Government's proposals for a new control system less attractive. Secondly, if this approach is adopted we could end up with more spending (including barter deals) than would have taken place had Mr Ridley never tried to control barter deals.

iii. Generous transitional arrangements. Local authorities could be given extra spending power to cover barter deals in the pipeline. Deals which the local authority were committed to would be allowed through. And deals which local authorities had approved in principle might also be accommodated. As a result local authorities existing plans for barter deals would be allowed through. Recorded gross spending and in-year receipts would be increased, but there would be no net effect on the planning total or the PSBR. In future, deals would have to be arranged within the constraints of the capital

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control system. This approach ensures that any concessions have a smaller effect on gross spending than the original decision to control barter deals.

**Future years**

6. Mr Ridley is likely to want to say that, in future, spending power will be set higher to reflect the fact that barter deals (and leasing deals) have been brought within the control system. We will need to check the form of words he wishes to use. But now that the scope for arranging capital spending outside the control system has been substantially reduced, there is a case for allowing higher gross spending within the control system, provided it is offset by higher receipts. We would then have stopped a growing amount of uncontrolled and unrecorded expenditure and increased the Government's plans for future gross spending without increasing the planning total.

**Action**

7. Mr Ridley will consider these options and write to you, probably seeking a decision by close on Friday 22 April. He may also raise the issue at Cabinet tomorrow.

R. M. Perfect.

R M PERFECT



CONFIDENTIAL

2 MARSHAM STREET  
LONDON SW1P 3EB  
01-212 3434

My ref:

Your ref:

The Rt Hon John Major MP  
Chief Secretary  
HM Treasury  
Parliament Street  
LONDON  
SW1P 3AG

CHIEF SECRETARY	
REC.	21 APR 1988
ACTION	Mr Potter
COPIES TO	Cy, Sir P. M. Delaney Mr Anderson, Mr Phillips Mrs Case, Mr Hanston Mr Perfect, Mr Call

21 April 1988

Dear Chief Secretary

We had a word the other day about the consequences of my statement in the House on 9 March. The amendments to the capital control legislation which I announced in that statement are due to be taken on Monday immediately before Third Reading of the Local Government Finance Bill and the Opposition's motion against the regulations made on 9 March will be debated later that evening.

The reaction to the statement has amply confirmed that we had correctly identified the loopholes which local authorities were using to avoid the effect of capital expenditure and borrowing controls. If anything, it shows that we had underestimated the extent to which leasing and barter, and in particular the latter, were being used.

The statement was of necessity made without prior consultation or notice. For that reason, I said I would consider extra capital allocations for schemes caught by the changes. Such schemes fall into two categories: those which were already in the pipeline at the time of the statement, for which we have to be reasonably generous, and those for which no commitments had been entered into, but which would be treated unreasonably under the new rules we have introduced.

On the first category, inevitably there were many schemes which were caught by the changes in the primary and secondary legislation but to which the authorities concerned (and in some cases other parties) were committed in the sense of having incurred expenditure (for instance on acquisition of sites or on design work) or having entered into other obligations (for instance rehousing tenants). I have received many representations about such schemes and I am satisfied that it is right that we should be generous in issuing capital allocations to cover such cases. Most of the schemes concerned were originally framed as barter deals and the effect of making available an additional

ok  
This was what  
Mr Ridley raised  
yesterday  
AA



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allocation would be that they would now be carried out on a cash basis. The expenditure would be matched by an equal and opposite receipt, so there would be no net public expenditure consequences and conditions would be attached to any allocations that would preclude additional borrowing or the use of spending power in future years. In the case of short-leases, I understand that the Treasury's view is that the taking of such leases should not be recorded as public expenditure, so there would likewise be no adverse public expenditure consequences.

The criteria that I would propose to use in considering "pipeline" cases would be that:-

- (i) expenditure has been incurred, or substantive negotiations or moral commitments entered into by the local authority or a third party; and
- (ii) the scheme is not designed primarily to increase the stock of physical assets over which the local authority has effective control or to raise money on the strength of operational assets.

Turning to schemes which were not in the pipeline on 9 March, the principal reason why local authorities seek to use barter deals is to avoid the present restrictions on the rate at which they may use their capital receipts to justify new expenditure. We have recently discussed at E(LF) the general question of the use of capital receipts and I need not rehearse the arguments now. It has, however, to be conceded that the existing rules work harshly in cases where a receipt can only be realised as a result of expenditure having been incurred. Typically, this will happen where an operational building needs to be replaced before the site on which it stands can be released for sale. Many of the cases which have been drawn to my attention following the 9 March statement are of this type. The Audit Commission in their report on "Local Authority Property" have also drawn attention to the inhibiting effect of the capital control system on sensible property rationalisations.

We already have a very limited scheme under which additional allocations are given to facilitate "back-to-back" transactions under which authorities acquire land and then dispose of it again (typically as part of wider redevelopment by the private sector). What I propose is an enhancement of this scheme which would apply in cases where a local authority need to acquire land (or incur other capital expenditure) in order to release other land for development. I would propose to offer extra allocations for:-

- (i) the exchange of land for land;
- (ii) the replacement of existing assets held by the local authority by assets to be used for a similar purpose; or
- (iii) schemes in which the main intention is to facilitate the investment by the private sector in assets which when the scheme is complete will be owned, operated, and controlled by the private sector.



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Here again conditions would be attached to allocations to ensure that there was no net additional expenditure or borrowing.

I hope you will be content for me to announce these measures when moving the new clauses to the Local Government Finance Bill on Monday. I also hope that they will be sufficient to allay the concern which some of our supporters have expressed about the short-term consequences of the 9 March statement.

In the longer term, the 9 March measures do, however, have implications which ought now to be the subject of examination by officials. It is argued, with some justice, by the local authorities that the bringing of leasing and barter within controls represents a general reduction in the level of expenditure which they can incur. Some leasing (eg of offices for terms of less than 20 years) has hitherto been regarded as unexceptionable and likewise barter has been used by authorities for many years, though not indeed on the scale which has recently become apparent. Insofar as assets (eg houses) have been provided by such means, we have taken credit for them in estimating the outputs of our programmes. We have changed the control framework and the question arises of whether we should make some corresponding adjustment to the permitted level of spending power to reflect what one might call "legitimate" barter and leasing. I see two options, namely

- (i) an increase in what one might call the "baseline" level of allocations, which could be justified on the grounds that the existing allocations methodology is based on pre 9 March assumptions; or
- (ii) an increase in the prescribed proportion for non-housing receipts, which would be of particular assistance to shire counties and to those districts which have been most inclined hitherto to use barter.

These need further investigation and I do not propose to say anything about them on Monday. But I have asked my officials to examine the implications and to report in time for the launch of the new capital control regime.

I am sending copies of this to the Prime Minister, Peter Walker, Kenneth Baker, Paul Channon, John Moore, John Wakeham, David Waddington, and Sir Robin Butler.

Yours sincerely  
Roger Butler

N.R.  
NICHOLAS RIDLEY  
(Approved by the Secretary of State and signed in his absence)

# A digest

for Councillors and Officers

No. 108

21 APRIL 1988

## 150 DISTRICT COUNCIL PROJECTS IN JEOPARDY 000

ALMOST 150 local authority projects - worth more than £350 million - may be abandoned because of the Government's clampdown on leaseback and barter deals.

These schemes range in value from under £1 million to a mammoth £45 million housing development in Oxford and a £40 million redevelopment of Bournemouth's Pavilion entertainment centre.

Information from ADC members shows at least 65 districts have schemes which will be severely affected by the new rules announced by Environment Secretary Nicholas Ridley last month. They include a £10 million shopping and car park development and a £1.5 million housing scheme in Mr. Ridley's own Cirencester constituency.

These schemes will now count as prescribed expenditure and thus push councils over their capital spending limits. Yet they would allow community assets to be provided without spending ratepayers' money and would put vacant land to good use.

The Government has praised such joint ventures between local authorities and the private sector but now it is killing them off because a few councils exploited the system to evade spending limits.

Our members have acted responsibly. None have entered into "Brent type" arrangements, according to our information, and none of their barter or leaseback deals have been challenged on legal grounds.

The Association has urged the Government to think again. But if

it does stand firm the best to hope for is DOE approval for schemes which meet certain objectives, such as housing the homeless.

### MEMBERS ALLOWANCES

IN response to a letter from John Denison, Chairman of General Services, calling for discussions on members allowances, Michael Howard, Minister of State for Local Government has written that he believes that "the level of allowances is not unreasonable."

The whole of his reply was read to the General Services Committee, which was incensed to hear his assertion that "many of the representations I receive are to the effect that councillors are overpaid, rather than underpaid". He had not been persuaded that the value of the allowances had fallen substantially since 1974, and he had figures to show that 38% of authorities paid the maximum allowance irrespective of the length of duty. In his opinion, this was the sort of practice which brought the system into disrepute, and had to be taken into account in setting the maximum level.

However, he did say that the DOE were examining the whole basis of

remuneration in their response to the Widdicombe Report, to be published shortly, and he would then meet with the ADC on the issue.

### CITIZENS ADVICE BUREAUX

THE time is fast approaching when the demands on Citizens' Advice Bureaux will outstrip the ability of local authorities to fund them. This was the feeling of the General Services Committee when it considered the growing volume of enquiries dealt with by CABX about social security and debt.

The problem was highlighted this month when many CAB offices were forced to close on the first day of the new social security regulations by the crowds of people seeking help. It is also likely to be intensified by Legal Aid Bill which would allow bureaux to offer legal advice in areas previously the work of solicitors.

Other sources of funding need to be identified, such as from those agencies which have contributed towards the problems which bureaux are now being asked to resolve. A meeting has been arranged with the National Association of CABX.

### DON'T IGNORE US, LORD YOUNG

LOCAL authorities have a crucial role to play in the regeneration of urban areas, the ADC has told Lord Young. While welcoming the Department for Enterprise's objective to encourage business the ADC is unhappy local authorities' role in this field was ignored in the White Paper.

The majority of district councils are heavily involved in economic development and the public see councils as the place to go for advice. The Association would like to discuss with Government departments and other agencies how they can all co-ordinate their activities at a local level.

The lack of extra aid has also been a disappointment. Lord Young was told that the move away from automatic grants in development areas will make it more difficult to attract inward industry.

The ADC is doing a review of regional aid and will present its ideas to the Government next year.

### BREATHING SPACE ON COMPULSORY COMPETITION

A welcome was given to the Government's decision to move the starting date for compulsory competitive tendering of services back from 1 April next year to 1 August.

"Those extra months will be very useful for local authorities, especially those which will have to start contracting out the more difficult functions of refuse collection and vehicle maintenance," said ADC Chairman, Roy Thomason.

### ORAL TOBACCO PRODUCTS

THE Association was delighted to learn that Health Ministers propose to make safety regulations to prohibit the supply of tobacco products which take the form of small sachets and are sucked.

The ADC has previously expressed concern at the introduction of these Skoal Bandits to the UK, because of the evidence about cancer of the mouth, and the aggressive marketing campaign for the products aimed at the young.

### CEMR ASSEMBLY

Don't miss out on the Assembly of European Municipalities and Regions, which is to take place from 1-4 June in Glasgow. This important event for Britain coincides with Local Government Week and the National Garden Festival. Over 1,000 people from throughout Europe are already lined-up to attend.

*Any enquiries relating to the contents of this newsletter should be addressed to the Publishers:*

## **ASSOCIATION OF DISTRICT COUNCILS**

Secretary: Gordon McCartney

9 BUCKINGHAM GATE · LONDON SW1E 6LE

01-828 7931

CONFIDENTIAL

FROM: R M PERFECT

DATE: 21 April 1988

1. MR ROTTER <sup>BHP</sup> 21/4
2. CHIEF SECRETARY

cc

PPS

Sir Peter Middleton  
 Mr Anson  
 Mr H Phillips  
 Mrs Case  
 Mr Hawtin  
 Mr Turnbull  
 Mr Call

### LA CAPITAL CONTROLS

The Secretary of State for the Environment's letter of 21 April proposes concessions on barter, and sale and leaseback, deals. My minute of 20 April outlined the problem and the options.

2. Mr Ridley's proposals would allow local authorities to complete some of the deals that were caught by his announcement of 9 March. And he wishes to offer extra allocations to allow assets to be swapped for other assets. We recommend you agree subject to two provisos, which do not give DOE any difficulty. A draft letter is attached.

### "Pipeline" cases

3. Mr Ridley's immediate problem is caused by the large number of deals that local authorities are committed to but which, now that they have been brought within the scope of the LA capital control system, cannot be completed unless more spending power is issued. Mr Ridley wishes to issue extra allocations to cover these cases provided they are not intended to increase the local authority's stock of physical assets or to raise money. We recommend you agree. All of the deals will increase gross spending and capital receipts by offsetting amounts, so there will be no net effect on public spending.

### Future cases

4. Mr Ridley also wishes to extend the existing arrangements under which gross expenditure on assets can be offset against receipts

from sales of assets - with no net effect on public expenditure. He proposes to offer allocations to allow:

i. the exchange of land for land. There are no Treasury reasons for stopping this.

ii. the replacement of existing assets held by local authorities by assets to be used for a similar purpose. This also presents no problems except to the extent that extra economic activity is generated. However, on Monday E(LF) favoured allowing such deals under the new capital control system. And there are no effects on net public spending, so you need not object.

iii. Schemes intended to promote private sector investment in assets which will end up in the private sector. This is intended to allow DOE to approve town centre developments in which local authority assets may be involved. DOE say they intend to ensure the local authority does not retain an influence over those assets by selling the freehold and keeping a long lease. We have recorded the point in the draft letter.

#### Longer term

5. Mr Ridley also suggests officials should consider whether allocations should be set higher in future, now that barter deals and sale and leaseback deals have been brought within the control system. LG can discuss this with DOE and other departments over the next few weeks. But we see no reason why including these deals in the LA capital control system should increase public spending - any extra gross spending should be fully offset by higher public expenditure receipts.

R.M. Perfect.

R M PERFECT

**CONFIDENTIAL****DRAFT LETTER TO:**

The Rt Hon Nicholas Ridley AMICE MP  
Secretary of State for the Environment  
Department of the Environment  
2 Marsham Street  
LONDON SW1

April 1988

**LA CAPITAL CONTROLS**

Thank you for your letter of 21 April.

I am content with the line you propose to take on Monday on the understanding that, as stated in your letter, none of the barter and sale and leaseback deals allowed through as a result will increase net public spending. Where allocations are given to facilitate private sector investment, the local authority should not be allowed to keep any undue interest in that investment eg in the form of a long lease on property.

I also agree that officials need to consider the future effects of bringing barter, and sale and leaseback, deals within the capital control system. You identify two possible approaches in your letter. But both would increase net public expenditure. I see no reason why any higher gross spending should not be fully offset by extra capital receipts. But I am content for our officials to pursue this.

I am copying this letter to the Prime Minister, Peter Walker, Kenneth Baker, Paul Channon, John Moore, John Wakehan, David Waddington and Sir Robin Butler.

**JOHN MAJOR**

CH/EXCHEQUER	
REC.	22 APR 1988 ✓ 22/4
ACTION	CST
COPIES TO	

PUP

BFB to ALCA  
JFA.  
PRIME MINISTER



DUAL RUNNING: RATES AND THE COMMUNITY CHARGE

At E(LF) on 14 April we discussed my proposal that 4 inner London boroughs, Waltham Forest, Westminster, Kensington and Chelsea and Wandsworth should be excluded from the scope of dual running. The Sub-Committee were concerned that the implications of this proposal might not have been fully appreciated in relation to Westminster and Kensington and I was invited to speak again to the members of Parliament concerned.

We have now completed our soundings and found that the members concerned remain adamant that they support the view of the boroughs. In the case of Westminster about which there was most concern, the argument of the Borough is that they will have substantial balances in 1990 - election year - which might allow them to reduce the community charge by up to £130, though they would not necessarily wish to use all their balances at once. They also - correctly - expect to be gainers from the abolition of ILEA and are planning changes in policy which will automatically increase fee income. They are, therefore, confident that their actual 1990 community charge will be below £400 compared with the present projection of £471.

On this basis I remain of the view that we should not stand in Westminster's way. It is relevant also that it is not possible on the basis of the present criteria for selection to exempt Wandsworth where spending is £190 per head above GRE and not Westminster where spending is £158 above.

In line with the E(LF) conclusion therefore, I shall be announcing our proposal to increase the limit from £130 per head to £200 per head during proceedings on the Bill on Monday.

I am copying this to members of E(LF) and to Sir Robin Butler.

*RB Butler*

PP NR (approved by the Secretary of State and signed in his absence).  
22 April 1988

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1. ~~ASST~~  
2. ~~MP~~

10 DOWNING STREET  
LONDON SW1A 2AA

From the Private Secretary

25 April 1988

Dear Roger,

DUAL RUNNING: RATES AND THE COMMUNITY CHARGE

The Prime Minister was grateful for your Secretary of State's minute of 22 April. She is content for him to announce an increase in the limit from £130 to £200 per head during today's proceedings.

I am sending copies of this letter to the Private Secretaries to members of E(LF) and to Trevor Woolley (Cabinet Office).

Yes,  
Paul

Paul Gray

CH/EXCHEQUER	
REC.	25 APR 1988 ✓ 25
ACTION	CST
COPIES TO	

Roger Bright, Esq.,  
Department of the Environment.

CONFIDENTIAL





*Can I see Xpt*

FROM: A C S ALLAN  
DATE: 29 April 1988

*mprw*

PS/CHIEF SECRETARY

*BF 15/5*

ACSA  
BF/CS  
29/4

**1989-90 RATE SUPPORT GRANT SETTLEMENT FOR ENGLAND**

X The Chancellor has seen your minute of 19 April to Mr Phillips. He feels that trying to settle three years of forward grant is in principle a very good idea. He notes that that is something we will be doing automatically when the new planning total comes in, and sees advantages in making a move this year. He will be interested to see officials' further advice.

*ACSA*

A C S ALLAN

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FROM: R FELLGETT

DATE: 5 May 1988

*for prep*

- 1. MR POTTER *BHP 515*
- 2. CHIEF SECRETARY

- cc Chancellor
- Sir P Middleton
- Mr Anson
- Mr Phillips o/r
- Mr Hawtin
- Mr Turnbull
- Mr Gieve
- Mr Burns o/r
- Mr Call

*Ch*  
*I have some doubts. In view of importance, do you want to hold a meeting? (possibly with AJCE in guest appearance)*  
*AA*

1989-90 RATE SUPPORT GRANT SETTLEMENT FOR ENGLAND

My submission of 7 April discussed the following broad objectives for the 1989-90 RSG round:

- (i) a useful precedent before the Community Charge system starts in 1990-91 in England;
  - (ii) a firm settlement which generates, in practice, as much pressure on local authorities to moderate their spending as the settlement for 1988-89 did.
2. As you requested at your meeting with us, I now attach:
- (i) a matrix showing options for changes in expenditure provision and AEG, and the resulting grant percentages;
  - (ii) a draft of a letter which you might send Mr Parkinson immediately after a preliminary meeting with Mr Ridley.

The Matrix

3. I am afraid that some of the numbers have changed a little, as we have updated them. They are, however, still provisional as DOE will not have comprehensive information about local

FELLGETT  
515

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authority budgets for 1988-89 until later in May. Nor have the calculations and underlying assumptions been discussed with DOE officials.

4. Option D11 in the matrix is, we guess, the DOE objective. This increases provision, compared to local authorities own budgets, by a little more than the forecast GDP deflator, to allow for Community Charge preparation costs. With an unchanged grant percentage of 44.5% (after adjusting for the transfer of polytechnics) AEG is increased by £1,035 million.

5. The Treasury objective for the outcome of the negotiations which you discussed with us at your earlier meeting is around option D4 - an increase in provision of £1,500 million over the PEWP baseline, and an increase in AEG at settlement of £580 million over the 1988-89 settlement. Provision would then rise by a full 9% compared to the equivalent PEWP figure for 1988-89, and the increase of about 4.4% compared to local authorities' own budgets would (just) be credible. AEG would rise by £1,090 million compared to outturn for 1988-89. But on the assumption the underclaim of £510 million for 1988-89 would be repeated in 1989-90, the actual increase in grant would also be £580 million. That is in practice much the same as the actual increase for 1988-89, and it will therefore generate similar pressures on local authorities to control their expenditure.

6. You thought your opening position in E(LA) should be tough. You could therefore argue from the plans already agreed and published in the latest PEWP. This is option A2. You could decline to make any increase in provision as a result of local authorities again overspending the Government's plans. And, although there is as yet no forward plan for AEG, you could either argue that the 3.5% growth in provision between 1988-89 and 1989-90 in the last PEWP implied a similar percentage growth in AEG; or (roughly equivalently) that you would be prepared to see AEG, like provision, held broadly level in real terms. In cash at settlement, a 3.5% increase is £450 million. The grant percentage might even rise slightly - our calculations give 44.8% - demonstrating that you are not seeking a cut in the grant percentage for its own sake; rather, you are seeking to settle

Grant %  
43.1

I think this is losing tactics:  
a 44.8% grant percentage would be the grant percentage to establish to maintain even if we have to retreat later  
Our opening bid should be a cut in the grant percentage to establish to maintain even if we have to retreat later

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on a reasonable increase in grant and the percentage then depends on local authorities' own spending decisions.

7. The PEWP plan seems, however, a little difficult to defend even as an opening position. The arguments against it include:

(i) the increase of 3.5% was based on the then GDP deflator for 1989-90, which was increased in the FSNR to 4%;

(ii) no increase in the PEWP provision would mean planning on a cash cut in LA spending compared to their own budgets for 1988-89, which would be credible neither to the TCSC nor at Judicial Review;

(iii) although the increase in AEG at settlement would be £960 million compared to outturn for 1988-89, the grant underclaim with such an unrealistically low level of provision would be likely to rise from about £510 million in 1988-89 to around £1,250 million in 1989-90, leaving LAs at outturn with less grant in 1989-90 than in 1988-89.

The Cabinet Office will be able to advise Mr Parkinson of these points. I therefore suggest that your opening position should be to stick as closely as possible to the published plans.

8. When you write to Mr Parkinson, there is no need to quantify your opening position too precisely. You can consider exactly what it should be, in figures for AEG and provision, nearer the first meeting of E(LA). However, on provision, I expect that when you quantify your position you will need to depart from the PEWP plan at least as far as a round £½ billion claim on the Reserve - row B - to avoid a cash cut on LAs budgets for some services. Indeed, depending on your feel for the tactics, you might go as far as a £1 billion claim on the Reserve - row C - to offer the prospect of a little cash increase on LA budgets for all services. On AEG, you might go as far as an increase in line with general inflation - column 3; or

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propose a small real terms cut of  $\frac{1}{2}\%$  - column 2. The four possibilities are therefore B2-3 and C2-3; all would give you scope for further concessions on both AEG and provision within the objective.

9. My earlier submission suggested that you might make Mr Ridley a "take it or leave it" offer at a preliminary meeting, if he indicates that he would be prepared to look at options that do not simply maintain the grant percentage. Any such offer will need to be very close to the objective to stand any chance of success, but you will wish to leave a small margin for negotiation. The offer could therefore be: a claim on the Reserve of £1,250 million; and an increase in AEG, slightly above forecast inflation, of  $4\frac{1}{4}\%$  to help pay for the Community Charge. (This falls between rows C and D, and between columns 3 and 4; the grant percentage is about 43.3%.) You could easily raise it to an increase in AEG in line with inflation plus the cost of introducing the Community Charge, if Mr Ridley would settle for that.

10. It is also worth commenting on an apparent compromise like option C7. That would increase provision by £1 billion, with a corresponding transfer from the Reserve, leading to provision for 1989-90 in the next PEWP some 7.2% higher than the equivalent figure for 1988-89 in the last PEWP. And it would involve an increase in AEG at settlement of £775 million (which, because provision would be lower than under the D options, would lead to higher grant underclaim and an actual increase in AEG at outturn of around £575 million, in line with the objective). The settlement grant percentage would be 44.4%, very close to 44.5% in 1988-89.

11. The difficulty with such an option is that the increase in provision over local authorities' own budgets for 1988-89 would be just 2.7%. After reasonably realistic allowance had been made for expenditure under central government control - especially police pay and manpower and teachers' pay - a growth of only 1% or 2% over local authority budgets would be left for the bulk of services. Even if colleagues like Mr Baker

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and Mr Moore could accept this, it could be liable to legal challenge. This illustrates, of course, the nub of the problem with the grant percentage approach, as you might point out to Mr Ridley. Because local authorities have overspent by over £1 billion in 1988-89, an equivalent increase in provision may be needed for 1989-90, but that is no reason to finance half the 1988-89 overspend one year in arrears.

12. Nevertheless, if all your colleagues on E(LA) are adamant that the grant percentage must be maintained you will wish to leave options close to C7 open, as a last fallback. That would probably mean agreeing to a claim on the Reserve between the C and D options, and a correspondingly higher increase in AEG, rather worse than the objective.

**The Letter to Mr Parkinson**

13. The draft letter sets out fairly fully the main arguments for a firm approach to the RSG settlement, and in broad terms your negotiating position. It also touches on the counter-arguments. And it hints that you would be prepared to modify your position a little in discussion; it could undermine the credibility of the main argument to leave out such a hint, although you will wish to avoid any suggestion that you could modify your position very significantly.

**Next Steps**

14. You planned to have a brief word with Mr Parkinson, and then a meeting with Mr Ridley followed by your letter to Mr Parkinson. Recent events have not, unfortunately, improved the climate for a discussion. In the Community Charge debates in the House several Government supporters called for reductions in prospective Community Charges, financed by increases in grant (or by direct funding of education, which is equivalent). Only Mr Heseltine drew attention to the public expenditure counter-argument. The district council elections today may also affect the climate.

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15. Cabinet Office are considering a first meeting of E(LA) in the week beginning 23 May, as Mr Parkinson is abroad after the Whitsun Bank Holiday until about 14 June. DOE officials have just told us that, after further discussion with their Ministers, they hope to show us a draft of Mr Ridley's paper next week. A second E(LA) meeting could not take place until the second half of June, which would leave time for further work and bilateral contacts in the first half of June.

16. I therefore suggest that it would be preferable to meet Mr Ridley first towards the end of the week beginning 9 May. That would leave time for a further discussion, if appropriate, before E(LA)'s first meeting.

17. If you are broadly content with the line of argument and the negotiating position in the draft letter, we will prepare more detailed briefing for a meeting with Mr Ridley accordingly.

*Robi Fellgett*

R FELLGETT

SETTLEMENT GRANT PERCENTAGES, AT VARIOUS LEVEL OF AEG AND EXPENDITURE PROVISION

% Increase in AEG over 1988-89 settlement (cash increase in AEG at settlement:  
cash increase in AEG at settlement over grant actually being paid in 1988-89)

	1	2	3	4	5	6	7	8	9	10	11
<u>Claim on the 1989-90 Reserve</u>	3.0%	3.5%	4.0%	4.5%	5.0%	5.5%	6.0%	6.5%	7.0%	7.5%	8.0%
(% change on 1988-89 PEWP provision: % change on LA's own 1988-89 budgets)	(£390m : £900m)	(£450m : £960m)	(£515m : £1,025m)	(£580m : £1,090m)	(£645m : £1,155m)	(£710m : £1,220m)	(£775m : £1,285m)	(£840m : £1,350m)	(£905m : £1,415m)	(£970m : £1,480m)	(£1,035m : £1,545m)
A. £0m (+3.5% : -0.9%)	44.6	44.8	45.0	45.2	45.5	45.7	45.9	46.1	46.3	46.5	46.7
B. £500m (+5.3% : +0.9%)	43.8	44.0	44.3	44.5	44.7	44.9	45.1	45.3	45.5	45.7	45.9
C. £1,000m (+7.2% : +2.7%)	43.1	43.3	43.5	43.7	44.0	44.2	44.4	44.6	44.8	45.0	45.2
D. £1,500m (+9.0% : +4.4%)	42.4	42.6	42.8	43.1	43.3	43.5	43.7	43.9	44.1	44.3	44.5

NB: (1) Settlement grant percentage for 1988-89 = 44.5%

(2) Actual grant percentage for 1988-89 (after overspending and grant underclaim) = 41.2%

*97.5% had*

*Tsy 'Objective'*

*DVE 'Objective'*



## CONFIDENTIAL

## DRAFT LETTER TO MR PARKINSON

## 1989-90 RATE SUPPORT GRANT SETTLEMENT FOR ENGLAND

I mentioned to you a little while ago that I was planning to discuss with Nicholas Ridley the approach that we might take to the 1989-90 Rate Support Grant settlement, before E(LA) begins its work. I thought it would be helpful to you to let you have this personal note of the approach I plan to take [, and the progress that I have made with Nicholas].

2. The rapid rate at which local authority current spending is increasing causes me quite considerable problems. As you know, we are pledged to reduce the proportion of national income that is absorbed by public expenditure. Overall, taking central and local government together, this is being achieved. But that achievement is in spite of the record of local authorities. We estimate that over the three years to 1988-89, local authority current spending will have grown by almost 30%, compared with inflation of 13%. The resulting real growth in expenditure is significantly higher than growth in the economy as a whole. Such rapid increases in local authority spending can therefore only be accommodated within our overall objective by taking a much more restrictive attitude to central government expenditure programmes; they have to more than offset the increasing share of GDP pre-empted by local authorities.

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3. A good deal of the problem lies with local authority pay and manpower. We could have accommodated priorities like the growth in police numbers and their generous formula pay rises, and the high pay award for teachers in 1987. But double figure pay increases like those that the local authorities - led on the management side by our opponents - have conceded to manual workers have been a major element fuelling the increase in expenditure. Such increases are also hardly in the wider best interests of the economy and the control of inflation. Local authority manpower has also been increasing recently (despite falling school rolls, which is the major demographic pressure on authorities) in sharp contrast to the achievements on manpower of central government.

4. In many ways, the position is worse than the real increases in local authority expenditure which we faced in 1979-80 and 1980-81. Our answer then was the new block grant system, targets for expenditure and penalties for exceeding them, and a series of tough RSG settlements with very limited cash increases in Aggregate Exchequer Grant over several years. Only as those financial pressures on local authorities were relaxed in 1986-87 and 1987-88 have we seen such a rapid rate of increase in their expenditure.

5. Part of the answer to the present problem is the Community Charge and the other changes in local government finance which will go with it, accompanied by a firm attitude to increases in grant. But I would not want to be complacent

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and wait until 1990. On the contrary, I am encouraged by the fact that the firmer RSG settlement for 1988-89 (at outturn, after allowing for grant held back in both years, the increase in AEG is likely to be a little over £½ billion, compared to nearly £1 billion for 1987-88) seems to have contributed to a modest slow-down in the rapid rate of increase in local authority expenditure. But the results are by no means as good as those achieved in the mid-1980s, when real cuts in AEG each year were the norm.

6. For 1989-90 I would therefore like to build on the progress in 1988-89, and give local authorities stronger financial incentives to behave responsibly. I do not, however, plan to propose to colleagues that we reintroduce the target and penalty system. I recognise the difficulties that could cause on our own backbenches. Nor do I intend to propose anything that would require further legislation; I am sure the business managers could do without any more controversial local government finance Bills.

7. I will therefore propose that we should stick as closely as possible to our agreed and announced plans for local authority expenditure provision, which were contained in the last Public Expenditure White Paper. Those allowed for increases in line with inflation (then assumed to be 3.5% in 1989-90). We must not be pushed into big increases in the plans simply because local authorities have overspent so badly again in 1988-89.

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8. Similarly, we should increase Aggregate Exchequer Grant by no more than is needed to cover general inflation; and, indeed, I see merit in the signal that a small real cut in grant would give to local authorities. (I will also argue for the minimum increase in GREs, or assessed spending needs, to avoid any inappropriate signals. But that is a more technical point.)

9. It is essential that we should not again fall into the trap of increasing AEG in proportion to any increase in provision, to finance part of the overspend in the earlier year within the higher level of provision. That would be the inevitable effect of tying ourselves to the idea that grant should be some fixed percentage of local authority expenditure provision. I recognise that we did this for 1987-88 and, with some modifications, for 1988-89. It was widely welcomed by local authorities. I am not surprised. They know that it leaves the initiative with them to decide pay increases and expenditure levels, in the knowledge that the Government will, with only a year's delay, come up with almost half the necessary cash. To allow local authorities to dictate to us the level of taxpayers' subsidy in this way is particularly damaging on the pay front, where we have repeatedly said that we will not finance excessive pay awards agreed by the local authorities and their unions. I am anxious to maintain our credibility following several excessive awards recently.

10. Some might argue that a firmer settlement for 1988-89 than for 1987-88 would lead to unacceptable rates

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increases. But rates increases in 1988-89 are likely to average around 7%, little more than in 1987-88, despite the lower increase in AEG. And the experience up to 1985-86 also shows that a firm stance on grant leads, not to a rates explosion, but to more moderate expenditure increases and hence acceptable rates rises.

11. I have discussed this with Nicholas Ridley. [To be added.]

12. I hope it is helpful to you to set out my position in this way. Obviously I will consider further the points [which Nicholas has put to me, and others] which other colleagues may wish to put in E(LA). I am very much aware of the priority that should be attached to policies involving local authority expenditure, such as education reform, the police, and the launch of the Community Charge. But am bound to warn you that I have only limited room for manoeuvre. I must also bear in mind our priorities within central government expenditure, including the health service, social security and defence. Within our overall objective that public expenditure should form a decreasing proportion of national income, a firm stance towards local authority expenditure as a whole is essential.



M.L. SAUNDERS  
LEGAL SECRETARY

LAW OFFICERS' DEPARTMENT  
ROYAL COURTS OF JUSTICE  
LONDON, WC2A 2LL

9 May 1988

Miss J L Wheldon  
Treasury Solicitor's Department  
Queen Anne's Chambers  
28 Broadway  
LONDON S W 1

*Jean Juhel,*

TREATMENT OF THE COMMUNITY CHARGE IN THE RPI - INDEXED GILTS

The Attorney General has considered the Instructions enclosed with your letter to me of 18 April. He has also seen the attached note of advice given by Treasury Counsel in Conference.

The Attorney has noted that Article 23 of the Prospectus posits a change in the "coverage" of the Index, not in the nature of the Index, or the nature of the coverage of the Index. If an item in the Index disappears, there is a sound argument that its disappearance does not constitute a change in the coverage of an Index that used to cover the expenditure it represented. Coverage can be exercised only over something that is there to be covered. The disappearance of something that used to be covered constitutes, following this argument, a change in the field available to be covered, not in the coverage.

*← Article 14 of current prospectus*

Nevertheless the Attorney has concluded that the courts are more likely to approach the interpretation of Article 23 by asking themselves what was the purpose of the insertion of Article 23 of the prospectus. It is very likely that the courts would determine that its aim was, inter alia, to protect the investor, whose interest lay in his proposed investment being protected against 'inflation', from the consequences of the disappearance from the RPI of an item as significant as rates. In that event they would consider its disappearance as falling clearly within the mischief of the provision.

The Attorney therefore agrees with the conclusions reached by Treasury Counsel.

Yours ever,  
P. Chad.

M L SAUNDERS

NOTE OF A CONFERENCE WITH MR JOHN MUMMERY

THURSDAY 28 APRIL 1988

Treatment of the Community Charge in the RPI - Indexed Gilts

Treasury Counsel advised that the questions submitted to him and to the Attorney General did not involve a consideration of the propriety of including or excluding the community charge in the calculation of the RPI. The answers to the questions turned solely on an interpretation of the terms of Article 23 of the Prospectus. That Article provided that "If any change should be made to the coverage or the basic calculation of the Index, which, in the opinion of the Bank of England, constitutes a fundamental change in the Index which would be materially detrimental to the interests of stockholders, H.M. Treasury will...". In the view of Treasury Counsel, the removal of rates from the Index (or rather their near removal), with or without their substitution by the community charge, would be regarded by the courts as a "change" to the "coverage" of the Index. Rates were separately identified as an item in Enclosure 2 to the Instructions. It would be extremely difficult to persuade any court that "coverage" did not mean the items listed in that document. Whilst there was a sound intellectual argument along the lines of paragraph 6 of the Instructions that the removal of rates from the list, on the ground that they no longer existed, would not change the basic "coverage" of the RPI, the courts would not be likely to accept it. The courts might well approach the matter by asking the question whether there had been any material detriment to the stockholders. If they concluded that there had been such detriment, it would be very difficult to persuade them, in the light of their likely view of the mischief of the Article, that there had been no relevant "change" in the coverage.



Counsel concluded therefore that Option C would involve a change in the coverage of the RPI and that it would trigger the option of redemption, if - as was probable - the Bank of England advised that there was a material detriment.

Option B would also trigger the gilts redemption provision, the detriment to stockholders having to be compared either with Option A or with a projected continuation of the status quo.

Option A would probably be held by the Bank not to be detrimental and therefore would not trigger the change. In this context, the courts would be very unlikely to accept an argument that, by virtue of the different nature of rates and the community charge, there had been two separate "changes", the first being the removal of rates, itself triggering the redemption provision, the second being the addition of the community charge.

Counsel also advised that it was unlikely that there could be a change in the coverage or calculation of the RPI which was materially detrimental to stockholders but not "fundamental" for the purposes of the redemption clause.

*Approved note drafted in conference*

*John Manning  
Jincoln*

*21<sup>st</sup> April 88.*

9/5/88.

M-Peretz

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THE TREASURY SOLICITOR  
Queen Anne's Chambers  
28 Broadway London SW1H 9JS

Telephones DIRECT LINE 01-~~273~~ 210-3049  
SWITCHBOARD 01-273 3000  
Telex 917564 GTN 273

Please substitute the attached for page 3 of the Instructions "Treatment of the Community Charge in the RPI - Indexed Gilts". There is a small change at the end of paragraph 3.

With the Compliments of

*John Holden*

# CONFIDENTIAL

3. Referring to income tax and certain other payments that are excluded from the RPI the 1956 Advisory Committee (Paragraph 24 of Enclosure 5) said "most expenditure [of this type] is excluded from the weighting pattern because of the variable and non-measurable nature of the services acquired in return for the payments made and because of the difficulty or impossibility of identifying a "unit" the price of which could be measured from date to date (see para 7 of Enclosure 4)". It has in the past been suggested that rates should be excluded from the RPI (para 41 of Enclosure 5) as they are a form of local taxation, rather than a direct payment for services provided. It has been concluded however that as the taxation is on the occupation of property, it is appropriate to include it as a housing cost, just as other expenditure taxes are included as a cost of the product or service to which they relate. Rates are therefore included in the RPI as are VAT, excise duty, TV licences and vehicle excise duty (which, like rates, is separately listed in Enclosure 2) and the principle was reaffirmed in 1987.
4. The community charge is not related to the consumption of a specific service - unlike rates which are assessed on the rental value of a particular property - and it should, according to the principles outlined above, be excluded from the RPI. The Central Statistical Office are for the same reasons minded not to classify the community charge as a tax on expenditure, which is how they classify rates, and are considering drawing a new distinction in the national accounts between direct taxes, which will include the community charge, and indirect taxes, which would include rates (Enclosure 6).

4591 Rec. 4.5.88

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Not to be copied



M.L. SAUNDERS  
LEGAL SECRETARY

LAW OFFICERS' DEPARTMENT  
ROYAL COURTS OF JUSTICE  
LONDON, WC2A 2LL

9 May 1988

SAUNDERS  
WHELDON  
9/9

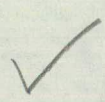
Miss J L Wheldon  
Treasury Solicitor's Department  
Queen Anne's Chambers  
28 Broadway  
LONDON S W 1

Jean Inheldt,

TREATMENT OF THE COMMUNITY CHARGE IN THE RPI - INDEXED GILTS

The Attorney General has considered the Instructions enclosed with your letter to me of 18 April. He has also seen the attached note of advice given by Treasury Counsel in Conference.

← Article 14 of current prospectus



The Attorney has noted that Article 23 of the Prospectus posits a change in the "coverage" of the Index, not in the nature of the Index, or the nature of the coverage of the Index. If an item in the Index disappears, there is a sound argument that its disappearance does not constitute a change in the coverage of an Index that used to cover the expenditure it represented. Coverage can be exercised only over something that is there to be covered. The disappearance of something that used to be covered constitutes, following this argument, a change in the field available to be covered, not in the coverage.

Nevertheless the Attorney has concluded that the courts are more likely to approach the interpretation of Article 23 by asking themselves what was the purpose of the insertion of Article 23 of the prospectus. It is very likely that the courts would determine that its aim was, inter alia, to protect the investor, whose interest lay in his proposed investment being protected against 'inflation', from the consequences of the disappearance from the RPI of an item as significant as rates. In that event they would consider its disappearance as falling clearly within the mischief of the provision.

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The Attorney therefore agrees with the conclusions reached by Treasury Counsel.

Yours ever,  
P. Hood.

M L SAUNDERS

NOTE OF A CONFERENCE WITH MR JOHN MUMMERY

THURSDAY 28 APRIL 1988

Treatment of the Community Charge in the RPI - Indexed Gilts

Treasury Counsel advised that the questions submitted to him and to the Attorney General did not involve a consideration of the propriety of including or excluding the community charge in the calculation of the RPI. The answers to the questions turned solely on an interpretation of the terms of Article 23 of the Prospectus. That Article provided that "if any change should be made to the coverage or the basic calculation of the Index, which, in the opinion of the Bank of England, constitutes a fundamental change in the Index which would be materially detrimental to the interests of stockbrokers, H.M. Treasury will...". In the view of Treasury Counsel, the removal of rates from the Index (or rather their near removal), with or without their substitution by the community charge, would be regarded by the courts as a "change" to the "coverage" of the Index. Rates were separately identified as an item in Enclosure 2 to the Instructions. It would be extremely difficult to persuade any court that "coverage" did not mean the items listed in that document. Whilst there was a sound intellectual argument along the lines of paragraph 6 of the Instructions that the removal of rates from the list, on the ground that they no longer existed, would not change the basic "coverage" of the RPI, the courts would not be likely to accept it. The courts might well approach the matter by asking the question whether there had been any material detriment to the stockholders. If they concluded that there had been such detriment, it would be very difficult to persuade them, in the light of their likely view of the mischief of the Article, that there had been no relevant "change" in the coverage.

Counsel concluded therefore that Option C would involve a change in the coverage of the RPI and that it would trigger the option of redemption, if - as was probable - the Bank of England advised that there was a material detriment.

Option B would also trigger the gilts redemption provision, the detriment to stockholders having to be compared either with Option A or with a projected continuation of the status quo.

Option A would probably be held by the Bank not to be detrimental and therefore would not trigger the change. In this context, the courts would be very unlikely to accept an argument that, by virtue of the different nature of rates and the community charge, there had been two separate "changes", the first being the removal of rates, itself triggering the redemption provision, the second being the addition of the community charge.

Counsel also advised that it was unlikely that there could be a change in the coverage or calculation of the RPI which was materially detrimental to stockholders but not "fundamental" for the purposes of the redemption clause.

*Approved note drafted in accordance*

*John Munnery  
Lincoln Inn*

*21<sup>st</sup> April 1988.*

TENDERS MUST BE LODGED AT THE BANK OF ENGLAND, NEW ISSUES (Y), WATLING STREET, LONDON, EC4M 9AA NOT LATER THAN 10.00 A.M. ON THURSDAY, 5TH JANUARY 1984, OR AT ANY OF THE BRANCHES OF THE BANK OF ENGLAND OR AT THE GLASGOW AGENCY OF THE BANK OF ENGLAND NOT LATER THAN 3.30 P.M. ON WEDNESDAY, 4TH JANUARY 1984.

29/12/83

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ISSUE BY TENDER OF £300,000,000

## 2 per cent INDEX-LINKED TREASURY STOCK, 1990

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PAYABLE IN FULL WITH TENDER

INTEREST PAYABLE HALF-YEARLY ON 25TH JANUARY AND 25TH JULY

1. The Stock is an investment falling within Part II of the First Schedule to the Trustee Investments Act 1961. Application has been made to the Council of The Stock Exchange for the Stock to be admitted to the Official List.
2. THE GOVERNOR AND COMPANY OF THE BANK OF ENGLAND are authorised to receive tenders for the above Stock.
3. The principal of and interest on the Stock will be a charge on the National Loans Fund, with recourse to the Consolidated Fund of the United Kingdom.
4. The Stock will be registered at the Bank of England or at the Bank of Ireland, Belfast, and will be transferable, in multiples of one penny, by instrument in writing in accordance with the Stock Transfer Act 1963. Transfers will be free of stamp duty.
5. If not previously redeemed under the provisions of paragraph 14, the Stock will be repaid on 25th January 1990. The value of the principal on repayment will be related, subject to the terms of this prospectus, to the movement, during the life of the Stock, of the United Kingdom General Index of Retail Prices maintained by the Department of Employment, or any Index which may replace that Index for the purposes of this prospectus, such movement being indicated by the Index figure issued monthly and subsequently published in the London, Edinburgh and Belfast Gazettes.
6. For the purposes of this prospectus, the Index figure applicable to any month will be the Index figure issued seven months prior to the relevant month and relating to the month before that prior month; "month" means calendar month; and the Index ratio applicable to any month will be equal to the Index figure applicable to that month divided by the Index figure applicable to January 1984.
7. The amount due on repayment, per £100 nominal of Stock, will be £100 multiplied by the Index ratio applicable to the month in which repayment takes place. This amount, expressed in pounds sterling to four places of decimals rounded to the nearest figure below, will be announced by the Bank of England not later than the business day immediately preceding the date of the penultimate interest payment.
8. Interest will be payable half-yearly on 25th January and 25th July. Income tax will be deducted from payments of more than £5 per annum. Interest warrants will be transmitted by post.
9. The first interest payment will be made on 25th July 1984 at the rate of £1.1333 per £100 nominal of Stock.
10. Each subsequent half-yearly interest payment will be at a rate, per £100 nominal of Stock, of £1 multiplied by the Index ratio applicable to the month in which the payment falls due.
11. The rate of interest for each interest payment other than the first, expressed as a percentage in pounds sterling to four places of decimals rounded to the nearest figure below, will be announced by the Bank of England not later than the business day immediately preceding the date of the previous interest payment.



12. If the Index is revised to a new base after the Stock is issued, it will be necessary, for the purposes of the preceding paragraphs, to calculate and use a notional Index figure in substitution for the Index figure applicable to the month in which repayment takes place and/or an interest payment falls due ("the month of payment"). This notional Index figure will be calculated by multiplying the actual Index figure applicable to the month of payment by the Index figure on the old base for the month on which the revised Index is based and dividing the product by the new base figure for the same month. This procedure will be used for each occasion on which a revision is made during the life of the Stock.

13. If the Index is not published for a month for which it is relevant for the purposes of this prospectus, the Bank of England, after appropriate consultation with the relevant Government Department, will publish a substitute Index figure which shall be an estimate of the Index figure which would have been applicable to the month of payment, and such substitute Index figure shall be used for all purposes for which the actual Index figure would have been relevant. The calculation by the Bank of England of the amounts of principal and/or interest payable on the basis of a substitute Index figure shall be conclusive and binding upon all stockholders. No subsequent adjustment to such amounts will be made in the event of subsequent publication of the Index figure which would have been applicable to the month of payment.

14. If any change should be made to the coverage or the basic calculation of the Index which, in the opinion of the Bank of England, constitutes a fundamental change in the Index which would be materially detrimental to the interests of stockholders, Her Majesty's Treasury will publish a notice in the London, Edinburgh and Belfast Gazettes immediately following the announcement by the relevant Government Department of the change, informing stockholders and offering them the right to require Her Majesty's Treasury to redeem their stock. For the purposes of this paragraph, repayment to stockholders who exercise this right will be effected, on a date to be chosen by Her Majesty's Treasury, not later than seven months from the last month of publication of the old Index. The amount of principal due on repayment and of any interest which has accrued will be calculated on the basis of the Index ratio applicable to the month in which repayment takes place. A notice setting out the administrative arrangements will be sent to stockholders at their registered address by the Bank of England at the appropriate time.

15. Tenders must be lodged at the Bank of England, New Issues (Y), Watling Street, London, EC4M 9AA not later than 10.00 A.M. ON THURSDAY, 5TH JANUARY 1984, or at any of the Branches of the Bank of England or at the Glasgow Agency of the Bank of England not later than 3.30 P.M. ON WEDNESDAY, 4TH JANUARY 1984. Each tender must be for one amount and at one price which is a multiple of 25p. Tenders will not be revocable between 10.00 a.m. on Thursday, 5th January 1984 and 10.00 a.m. on Tuesday, 10th January 1984. TENDERS LODGED WITHOUT A PRICE BEING STATED WILL BE REJECTED.

16. Tenders must be accompanied by payment in full, i.e. the price tendered for every £100 of the nominal amount of Stock tendered for. A separate cheque must accompany each tender; cheques must be drawn on a bank in, and be payable in, the United Kingdom, the Channel Islands or the Isle of Man.

17. Tenders must be for a minimum of £100 nominal of Stock and for multiples of Stock as follows:—

<i>Amount of Stock tendered for</i>	<b>Multiple</b>
£100—£1,000	£100
£1,000—£3,000	£500
£3,000—£10,000	£1,000
£10,000—£50,000	£5,000
£50,000 or greater	£25,000

18. Her Majesty's Treasury reserve the right to reject any tender or part of any tender and may therefore allot to tenderers less than the full amount of the Stock. Tenders will be ranked in descending order of price and allotments will be made to tenderers whose tenders are at or above the lowest price at which Her Majesty's Treasury decide that any tender should be accepted (the allotment price). All allotments will be made at the allotment price: tenders which are accepted and which are made at prices above the allotment price will be allotted in full; tenders made at the allotment price may be allotted in full or in part only. Any balance of Stock not allotted to tenderers will be allotted at the allotment price to the Governor and Company of the Bank of England, Issue Department.

19. Letters of allotment in respect of Stock allotted, being the only form in which the Stock may be transferred prior to registration, will be despatched by post at the risk of the tenderer, but the despatch of any letter of allotment, and the refund of any excess amount paid, may at the discretion of the Bank of England be withheld until the tenderer's cheque has been paid. In the event of such withholding, the tenderer will be notified by letter by the Bank of England of the acceptance of his tender and of the amount of Stock allocated to him, subject in each case to payment of his cheque, but such notification will confer no right on the tenderer to transfer the Stock so allocated.

20. No allotment will be made for a less amount than £100 Stock. In the event of partial allotment, or of tenders at prices above the allotment price, the excess amount paid will, when refunded, be remitted by cheque despatched by post at the risk of the tenderer; if no allotment is made the amount paid with tender will be returned likewise. Non-payment on presentation of a cheque in respect of any Stock allotted will render the allotment of such Stock liable to cancellation. Interest at a rate equal to the London Inter-Bank Offered Rate for seven day deposits in sterling ("LIBOR") plus 1 per cent per annum may, however, be charged on the amount payable in respect of any allotment of Stock for which payment is accepted after the due date. Such rate will be determined by the Bank of England by reference to market quotations, on the due date for such payment, for LIBOR obtained from such source or sources as the Bank of England shall consider appropriate.

21. Letters of allotment may be split into denominations of multiples of £100 on written request received by the Bank of England, New Issues, Watling Street, London, EC4M 9AA, or by any of the Branches of the Bank of England, on any date not later than 9th February 1984. Such requests must be signed and must be accompanied by the letters of allotment. Letters of allotment, accompanied by a completed registration form, may be lodged for registration forthwith and in any case they must be lodged for registration not later than 13th February 1984.

22. Tender forms and copies of this prospectus may be obtained at the Bank of England, New Issues, Watling Street, London, EC4M 9AA, or at any of the Branches of the Bank of England, or at the Glasgow Agency of the Bank of England, 25 St. Vincent Place, Glasgow, G1 2EB; at the Bank of Ireland, Moyne Buildings, 1st Floor, 20 Callender Street, Belfast, BT1 5BN; at Mullens & Co., 15 Moorgate, London, EC2R 6AN; or at any office of The Stock Exchange in the United Kingdom.

BANK OF ENGLAND  
LONDON

29th December 1983

CONFIDENTIAL

*Przy*

FELLGETT  
CST  
11/5

1. MR POTTER *BHP 11/5*
2. CHIEF SECRETARY

FROM: R FELLGETT

Date: 11 May 1988

cc: PS/Chancellor  
PS/Sir Peter Middleton  
Mr Anson  
Mr Phillips  
Mr Hawtin  
Mr Turnbull  
Mr Call

1989-90 RATE SUPPORT GRANT SETTLEMENT FOR ENGLAND

The matrix attached to my submission of 5 May refers primarily to options (labelled A-D) for claims on the 1989-90 Reserve to increase provision beyond the £27.70 billion allowed for in the latest public expenditure White Paper; and to options (numbered 1-11) for percentage increases in Aggregate Exchequer Grant for 1989-90 at settlement, compared to AEG in 1988-89 at settlement.

2. You asked for further quantitative information about the starting point of the E(LA) discussions. This is attached at Annex A. The numbers are all consistent with my earlier submission (of 5 May). I will update them when we have been able to discuss the figuring with DOE, probably next week.

3. You also asked about the **best possible settlement for 1989-90 which could be based on an unchanged grant percentage.** The calculations are at Annex B.

4. White Paper provision for "relevant current" expenditure for 1989-90 is closely related to the settlement assumption about all relevant expenditure, which in law (and hence to an extent politically) has to be defended as the Government's best estimate of what local authorities will (not should) spend. I think the **absolute minimum increase over local authorities actual budgeted expenditure in 1989** which could therefore be defended is 3%. **Even that is perhaps optimistic:** it is a 1% real terms cut (on the FSBR GDP deflator) after several years in which local authority expenditure has shown substantial real

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increases and arguably does not take account of the priorities like education and the introduction of Community Charge.

5. With a 3% uplift, the resulting claim on the Reserve would be £1.1 billion, and the increase in AEG at settlement would be £880 million or 6.8%. In my view, these figures, and the underlying endorsement of local authorities' pay decisions and overspending in 1988-89, are sufficiently unattractive to make it worthwhile attacking the concept of an unchanged grant percentage, even though that proved ultimately unsuccessful last year.

6. There is a third option which you might wish to consider. You might argue that you are perfectly happy to apply an unchanged grant percentage to what local authorities should spend; but you would not take account of what they actually spent in the past or future. Under this approach, you would argue that AEG should be a fixed percentage of aggregate GRE, which is the Government's assessment of what local authorities "need to spend". You would then argue that GREs should increase in aggregate by only about, say, 4½% (slightly more than inflation to cover Community Charge preparation costs), and AEG should similarly rise in proportion by 4½% (or by about £580 million).

7. The potential drawbacks of this approach are, however:

- (i) Mr Ridley has defended the last two settlements by referring to the fact that AEG has remained (roughly) a fixed percentage of relevant expenditure provision. He will have some difficulty defending the next one in terms of an unchanged grant percentage, because the polytechnics transfer has anyway reduced that percentage - local authority officials made that very clear to us and DOE earlier today. He would have even more difficulty if the defence was, in fact, in terms of a different percentage of something else. I guess that he is therefore unlikely to see attractions in this.

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(ii) Even if Mr Ridley is sympathetic to the view that AEG should be a percentage of what the Government believes authorities should spend, it may be difficult to persuade colleagues with expenditure responsibilities (eg Mr Hurd or Mr Baker) that "need to spend" is rising by little more than the rate of inflation. Local authorities have probably overspent aggregate CRE for 1988-89 by around £2 billion. Colleagues may well want to take some account of that, even though the strict logic suggests they should not, before adding on percentages for general inflation or any other specific items. There is therefore a danger that the approach would, in E(LA), turn out to be quite expensive.

On balance, I doubt if this an option worth running for 1989-90; but as Mr Potter's separate submission argues, it may be more useful under the new Community Charge regime.

*Hugh Burns*

P.P. R FELLGETT

ENGLISH LA EXPENDITURE AND GRANT

		£ billion	
	1988-89	1989-90	
1988 PEWP provision for 'relevant current' expenditure	26.77 (27.53)	27.70 (28.50)	
LA's actual budgeted 'relevant current' expenditure	27.96 (28.76)		
AEG at settlement	12.94 (13.78)		
AEG at outturn after grant underclaim	12.43 (13.26)		
Grant %* at settlement	44.5% (46.2%)		
Grant % at outturn, ie at actual spending and grant levels	41.2% (42.9%)		

\* ie AEG as a percentage of all relevant expenditure, including about £2.2 bn of items such as debt interest not treated as 'relevant current' (mainly also not classified as public expenditure).

Note: figures before the polytechnics adjustment are in brackets.

A GRANT PERCENTAGE SETTLEMENT

LA's actual budgeted spending on <u>all</u> relevant expenditure in 1988-89	£30,144 million
Uprated by 3%	£31,048 million
AEG at 44.5%	£13,817 million
LA's actual budgeted spending on 'relevant current' expenditure in 1988-89	£27,958 million
Uprated by 3%	£28,797 million

CONFIDENTIAL

FROM: BARRY H POTTER

DATE: 11 May 1988

CHIEF SECRETARY

cc PS/Chancellor  
PS/Sir P Middleton  
Mr Anson  
Mr Phillips  
Mr Hawtin  
Mr Turnbull  
Mr Fellgett  
Mr Call

*What's the agreement  
settled for so on to  
go for a new  
line for 1990/91,  
settled to  
the last year of  
1989/90  
We're having  
meeting next week  
AA*

RSG NEGOTIATIONS IN ENGLAND: 1989-90

I understand your meeting with the Secretary of State for Environment to discuss this year's RSG negotiations has now been fixed for the morning of Tuesday, 24 May. Yesterday I accompanied Mr Phillips to a tour d'horizon meeting with senior DOE officials; and they were rather more forthcoming about Mr Ridley's likely stance on the RSG settlement for 1989-90. Although we will brief later for the meeting, you may like to be aware now of Mr Ridley's thinking.

2. First, Mr Ridley proposes to take a very similar line to last year. His starting point will be local authorities' budgets for 1988-89 which are some 4% above the settlement spending assumption. He will argue that these aggregate budgets should be uplifted broadly in line with inflation; plus an extra amount for the costs of introducing the Community Charge; and less another small amount to allow for assumed efficiency gains. This figure, adjusted for authorities that are rate-capped, would form the provision for local authority expenditure in 1989-90. To this, he would propose to apply a broadly constant grant percentage (adjusted for the transfer of polytechnics) to derive AEG for next year.

3. This is essentially the line foreshadowed in Mr Fellgett's minute of 7 April. As you know the principal argument against it is that this approach effectively validates local authorities'



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overspending: it meets a fixed share of that overspending one year in arrears.

4. Second, Mr Ridley is apparently planning to display the likely outcome of such an RSG settlement, less in terms of the impact on rates in 1989-90, than by showing what Community Charges would have been next year. And he will go on to illustrate what Community Charges will be in 1990-91 on the basis of this settlement - clearly a critical issue for Ministers. This can be done on the basis of the proposals in last year's Yellow Booklet that:

"There will be a safety net designed to make sure that a local council will need to raise only the same amount from ..... Community Charges in 1990-91 as it raised from domestic rates in the previous year provided that it spends the same amount in real terms in both years."

5. Mr Ridley will clearly seek to play on colleagues' fears about the starting level of the Community Charge in 1990-91 and argue that we need to put in sufficient grant now to prevent excessive charges emerging. Our argument must be that we need to get local authorities' expenditure under firmer control now; it is excessive spending that will lead to excessive charges under the new regime. We must therefore build on the limited success this year; in response to a tougher grant settlement, there has been some reduction in the growth of LA spending. We must reinforce the pressure next year.

6. Third, we took the opportunity to contrast the growth in local government expenditure with that for central government over the last few years and focussed on excessive pay increases for LA manuals, the fire service etc and resumed growth in LA manpower, as the two principal factors driving the faster rate of growth. DOE officials did not seek to deny this but pointed out that, over a longer time scale, the trends looked rather better. Nonetheless, some senior DOE officials are sympathetic to the concerns about the faster growth in manpower and pay;

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*Volume Planning*

and they favour a more bottom up approach in this year's RSG papers looking at unit costs, service levels and how far efficiency savings identified by the Audit Commission can be taken into account.

7. On the one hand this approach may be advantageous in focussing more attention on the unpalatable facts about manpower and pay. But on the other there is a danger that a more disaggregated approach would allow the Departments to press their case for more resources to meet service commitments. We will investigate the possibilities further: but at this stage it is doubtful whether the points about pay and manpower can be made more effectively at a service level rather than on a macro basis.

#### Future RSG Settlements

8. Finally - and highly relevant to this year's RSG negotiations - DOE officials gave some important indications about Mr Ridley's longer term thinking on future settlements under the Community Charge regime. He sees the foundation of future settlements as being the figures which he and Mr Howard have quoted in recent articles and discussions on the Local Government Finance Bill: that Exchequer grant (RSG and specific grants) should amount to about 50% of local government current expenditure; the proceeds from NNDR, a further 25%; with the Community Charge making up the final 25%.

9. Clearly he is seeking to entrench the fixed grant percentage approach. But he is not yet clear about what this percentage would be applied to. He sees two options: the first would be based on a target path for the Community Charge. If that approach is pursued, we would be stuck with - at best - all the present problems of a fixed grant percentage applied to LAs' actual spending including any overspending above what the Government believes is appropriate. The second approach is to apply the grant percentage to the assessed need to spend, ie broadly (with definitional differences) aggregate GRES.

10. Two conclusions seem to emerge from this. First, we must seek to break the grant percentage argument if at all possible.

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There is no reason to assume that any particular division between the costs borne by taxpayers, business ratepayers and charge payers is correct. We should strive to maintain the freedom to shift that balance; we must preserve some room for manoeuvre to take account not just of overspending but also future changes in local authority functions. Nevertheless, given Mr Ridley's clear attachment to the grant percentage and accepting that it may be seen by colleagues as having political attractions, then our second best strategy should be to ensure that any grant percentage is applied to local authorities assessed need to spend and not their actual spending. This is quite clearly consistent with the logic of the new scheme.

11. Mr Fellgett's submission of today discusses the prospects of us taking such an approach for 1989-90. I agree with his conclusion in that, on balance, it is not worth running for next year. But we should bear it in mind both as a debating point for this year and more importantly for the new system after 1990. We must avoid at all costs any idea that such a grant percentage has to be applied to whatever local authorities spend, in order to keep down Community Charges in the future.

12. We will provide briefing for your meeting with Mr Ridley by the end of next week. In the meantime we are seeking further clarification of the figures; the proposed tone and style of presentation in E(LA) papers; and Mr Ridley's likely negotiating stance.

*Barry H. Potter*

**BARRY H POTTER**

PERETZ  
CHEX  
11/5

From : D L C Peretz  
Date : 11 May 1988

CHANCELLOR

*"In the opinion of the AG"*  
*Reference of how to RPI Adv. Cttee*  
*? grant + Coverage of*

cc Chief Secretary  
Sir P Middleton  
Mr Anson  
Sir T Burns  
Mr Scholar  
Mr Sedgwick  
Mr J Hibberd  
Miss O'Mara

Miss J Wheldon -  
Tsy. Sol.

**RPI AND THE COMMUNITY CHARGE : INDEX-LINKED GILTS**

A restricted meeting to discuss this is to be held tomorrow. I attach the Attorney General's advice. This is just about - though not quite - as unhelpful as it could be.

2. I am also attaching for reference a specimen index-linked gilt prospectus.

Treasury Counsel's Opinion and Attorney General's Advice

3. The question is whether or not the ending of rates, and their replacement by the Community Charge, creates a situation in which the redemption clause in the index-linked gilt prospectus is triggered because there is a change in "the coverage or basic calculation of the index which, in the opinion of the Bank of England, constitutes a fundamental change in the index which would be materially detrimental to the interests of stockholders". Treasury Counsel's opinion was that notwithstanding the intellectual arguments (which were put to him forcefully) :

(a) a court was likely to hold that removal of rates from the Index constitutes a change to the "coverage" of the index; and

(b) in any event, the court might well approach the matter back to front : first asking the question whether there

had been any material detriment to the stockholders (presumably as compared to the situation had rates continued), concluding that if there had been such detriment then there must have been a change in the coverage.

(a) if accepted would also, for example, imply that the clause might be triggered if some other item were to fall out of the index : for example if bank charges (a sub-item in calculation of the index) ceased to be levied. This possibility had never, hitherto, crossed our minds. Happily, the Attorney General does not accept (a), drawing a distinction between a change "in the field available to be covered" and in the "coverage". But he does think (b) is very likely. So we have no assurance of winning a case on this if it went to court : while what we were looking for was a fair degree of certainty of winning.

#### Possible courses of action

4. If we accept this advice we are left in the position where option A - putting the Community Charge into the RPI, despite the overwhelming intellectual case against - is the only one we could be sure would not trigger redemption of all outstanding index-linked stock. Putting the Community Charge into the RPI would clearly be a change both in its coverage and method of calculation. But the Bank of England should have no difficulty in concluding that the change would not be detrimental to the interests of stockholders.

5. This is extremely unsatisfactory. It suggests that in the index-linked prospectus we have constructed a machine for ensuring that changes to the RPI must always be such as to result if anything in a faster rate of growth in the index rather than a slower one.

6. We have therefore briefly considered other possible options :-

(a) we could redeem all the index-linked gilts outstanding. The prospectus requires us to make a redemption offer at the current redemption par value. If everyone accepted, the total amount involved is currently about £15½ billion. This is considerably in excess of the current market value of outstanding IGs, because without exception they stand below par. The difference between market value and current redemption value is around £2.9 billion, and this is probably the best measure of the "cost" of redeeming the stock and refinancing them. Indeed, since we think IGs are currently our cheapest form of financing, if the result of the operation were to destroy the IG market, and we had to refinance with conventionals, the cost would be rather larger than this. This is, of course, the capitalised value of the increase in debt servicing costs to HMG over the remaining life of the stock. The immediate impact on the PSBR would depend on the year by year increase in debt interest, which would depend on how we refinanced the IGs, but would be a much more modest annual amount.

| ( Apart from the cost, there would be some presentational  
 ) ( difficulty with this course. The Government would be  
 ) ( seen to be accepting that there was a change in the RPI;  
 ) ( that it was materially detrimental to stockholders; and  
 ) ( would be seen to be compensating holders of IGs - no  
 ) ( doubt leading to strong pressure to "compensate" others,  
 ) ( such as pensioners.

*Impossible*

(b) the prospectus may allow us to avoid redemption by asking the Bank to publish a different parallel RPI in future solely for the purpose of IGs. The prospectus refers to the RPI "or any index which may replace that index for the purposes of this prospectus". But we do not find this at all attractive. The Bank would not be able to calculate an index including rates, since they would no longer exist. If it published an index including the Community Charge then there would be

immense pressure to use this new index for benefit upratings, etc.

- (c) legislation retrospectively to change the prospectus and the rights of IG holders does not seem to be a runner. Apart from the usual objections to retrospection, we would be interfering with property rights and could be taken to the European Court.

*DL*

D L C PERETZ



purp

~~Alex~~

Juliet Wh rang. One  
suggested change for  
your CC/CR minutes

p2, para (i)

after... "equally  
buoyant" insert

"to rates"

k

m.





Juhet

cc David  
Peretz

CC, RPI & IGS

I should be grateful  
for any comments on  
the attached draft  
minutes

Alex Allan

13/5-

NOTE OF A MEETING IN THE CHANCELLOR'S ROOM HM TREASURY AT  
3.30 PM ON THURSDAY 12 MAY

Present: Chancellor  
Sir P Middleton  
Sir T Burns  
Mr Anson  
Mr Scholar  
Mr Peretz  
Mr Sedgwick  
Mr Hibberd  
Miss O'Mara  
Mr Cropper  
Miss Wheldon T.Sol

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**RPI AND THE COMMUNITY CHARGE: INDEX-LINKED GILTS**

Sir P Middleton said that the Attorney General had supported the view that if an item in the Retail Price Index disappeared, there was a sound argument that its disappearance did not constitute <sup>to</sup>~~ent~~ a change in the coverage; nevertheless, the Attorney had concluded that the Courts would be most likely to take the view that the aim of the Article in the prospectus was to protect the investor against inflation, and they would <sup>thus</sup><sub>A</sub> hold that the disappearance from the RPI of something as significant as rates would constitute a change in coverage.

Sir P Middleton noted that if the Bank took the view that the change was "materially detrimental" to stockholders, we should be at risk of having to redeem all indexed stock at par. The capital uplift involved would add about £3½ billion to the PSBR. <sup>for the year (with an offsetting reduction in future years)</sup> And it would <sup>be a</sup> ~~be a~~ <sup>deal</sup> ~~deal~~ <sup>major</sup> ~~devastating~~ blow to the indexed gilt market, <sup>which would</sup> ~~which would~~ <sup>would add to the cost of funding in the future.</sup>

In discussion, the following points were made:

*if the Courts upheld the Attorney's view, they*

*if the Courts took the view predicted by the Attorney, they*

i. It was not clear whether ~~the Courts~~ would feel that it was necessary to substitute the community charge for rates in the RPI, or whether it would be sufficient to add something equivalently buoyant, for example by expanding the weights on some other component of housing costs.

ii. It would, however, not be at all attractive to increase the weight on mortgage interest payments; and it was quite possible that rents would be more buoyant than rates. It would in any case be somewhat tricky technically to continue to uplift other weights every year.

iii. The Government had not yet formed a collective view on whether or not it would be desirable in principle for the community charge to be included in the RPI or not. While there seemed to be a strong case for excluding it, the Department of the Environment had been arguing that it should be included on the grounds that it was a charge for local services.

iv. There might in some circumstances be a case for <sup>considering a change to</sup> changing the prospectus of new index gilts issues to make the position <sup>for new issues clear.</sup> clear ~~beyond doubt~~. But it would certainly be inappropriate to do this until the existing position had been clarified.

v. It was agreed that the next step was to consult the Bank of England ~~about whether they would regard a proposal not to include the community charge in the RPI when rates dropped out (with the weights adjusted appropriately to prevent any discontinuity) as constituting~~ "a fundamental change in the index which would be materially detrimental to the interest of stock holders". <sup>It</sup> ~~It would be helpful if the submission to the Bank brought out clearly that~~ ~~it~~ had always been accepted that housing costs had to be in the Index, but there had long been difficulties in agreeing what the best way of including them was. It had early on been decided that house prices themselves were not appropriate; ~~and so~~ we had started with rents or imputed rents, <sup>before</sup> ~~subsequently~~ switching from imputed rents to the present mortgage interest formula. ~~This presentation would bring out more clearly the difference between rates and the community charge.~~

on which of the possible ~~changes~~ options would or would not constitute, in their view, contribute

Distribution  
Those present  
PS/Chief Secretary  
13 May 1988

A C S ALLAN

istribution

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MINUTES OF  
LAST MEETING &  
BACKGROUND PAPERS

PERSONAL AND CONFIDENTIAL



*[Handwritten signature]*

MINUTES OF A MEETING IN CHANCELLOR'S ROOM  
HM TREASURY AT 3.30 PM ON THURSDAY 12 MAY

Present:

Chancellor  
Sir P Middleton  
Sir T Burns  
Mr Anson  
Mr Scholar  
Mr Peretz  
Mr Sedgwick  
Mr Hibberd  
Miss O'Mara  
Mr Cropper  
Miss Wheldon T.Sol

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RPI AND THE COMMUNITY CHARGE: INDEX-LINKED GILTS

Sir P Middleton said that the Attorney General had supported the view that if an item in the Retail Price Index disappeared, there was a sound argument that its disappearance did not constitute a change in the coverage; nevertheless, the Attorney had concluded that the Courts would be most likely to take the view that the aim of the Article in the prospectus was to protect the investor against inflation, and they would thus hold that the disappearance from the RPI of something as significant as rates would constitute a change in coverage. Sir P Middleton noted that if the Bank took the view that the change was "materially detrimental" to stockholders, we should be at risk of having to redeem all indexed stock at par. The capital uplift involved would add about £3½ billion to the PSBR (with an offsetting reduction in future years). And it would deal a major blow to the indexed gilt market, which would add to the cost of funding in the future.



In discussion, the following points were made:

- i. It was not clear whether, if the Courts took the view predicted by the Attorney, they would feel that it was necessary to substitute the community charge for rates in the RPI, or whether it would be sufficient to add something equally as buoyant as rates, for example by expanding the weights on some other component of housing costs.
- ii. It would, however, not be at all attractive to increase the weight on mortgage interest payments; and it was quite possible that rents would be more buoyant than rates. It would in any case be somewhat tricky technically to continue to uplift other weights every year.
- iii. The Government had not yet formed a collective view on whether or not it would be desirable in principle for the community charge to be included in the RPI or not. While there seemed to be a strong case for excluding it, the Department of the Environment had been arguing that it should be included on the grounds that it was a charge for local services.
- iv. There might in some circumstances be a case for considering a change to the prospectus of new index gilts issues to make the position for new issuer clear beyond doubt. But it would certainly be inappropriate to do this until the existing position had been clarified.
- v. It had always been accepted that housing costs had to be in the Index, but there had long been difficulties in agreeing what the best way of including them was. It had early on been decided that house prices themselves were



not appropriate; we had started with rents or imputed rents, before switching from imputed rents to the present mortgage interest formula.

It was agreed that the next step was to consult the Bank of England on which of the possible options would or would not, in their view, constitute "a fundamental change in the index which would be materially detrimental to the interest of stock holders".

ACSA

A C S ALLAN

17 May 1988

Distribution

Those present

PS/Chief Secretary  
PS/Economic Secretary