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Chancellor's (Lawson's) Papers:
The Community Charge Safety Net.

DD's: 25 Years

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CABINET OFFICE PAPER

The following Cabinet Office papers have been taken off the file. If you require access to these papers please contact the Cabinet Office.

Reference	Date Of Paper
E (LF) (89) 3	16 June 1989
E (LF) (89) 2	19 June 1989
E (LF) (89) 2 ADDENDUM	20 June 1989
E (LF) (89) 4	20 June 1989

DEPARTMENT OF THE

ENVIRONMENT

NEWS RELEASE

1. cc Mr White
2. RF pl.

712

15 DECEMBER 1988

MOST HOUSEHOLDS TO PAY LESS WITH THE COMMUNITY CHARGE

New figures published today show that nearly 60 per cent of households would pay less with the community charge than they do now with domestic rates, Local Government Minister John Gummer told the House of Commons.

In a written Answer to a Parliamentary Question from Mr James Couchman MP (Gillingham), Mr Gummer said:

"I have today placed in the Library a note updating figures on the impact on household finances of the community charge. The new figures show that:

- when fully implemented 58 per cent of households (11.1m) will gain from the introduction of the community charge;

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- 83 per cent of single pensioner households and 75 per cent of other single adult households will gain from these proposals;

- percentage gains in net income are largest for the lowest income households;

- community charges on average would be less than domestic rates in all income bands up to £200 per week.

"The community charge will reduce the burden on the poorest. The lowest income group will pay less for Local Government. On average, their rates after rebates account for 3.9 per cent of net income, whereas the community change accounts for 3.0 per cent. Of course there will be gainers and losers in any change but these figures show that the community charge with its rebate system cuts the direct cost of local government to the poorest (those households with less than £50 a week) by nearly 25 per cent.

"Many poorer people pay more in rates than those who are better off, even in the same local authority, because there is no necessary connection between rateable value and ability to pay. Generally, people buy their homes while they are working, when their incomes are at their highest, but remain in the home and have to continue paying the same rates when they retire with reduced incomes. So it is no surprise that 41 per cent of households living in homes with above average rateable values have below average incomes.

"These figures demonstrate that the majority of households will in fact gain from the community charge; that the poorest households stand to gain; and that domestic rates do not reflect ability to pay.

"The revised figures take account of amendments made during the passage of the Local Government Finance Act 1988, local authorities budgetted spending levels in 1988-89, the 15 per cent community charge rebate taper announced on 14 April and incorporate the uprating of social security benefits announced for 1989-90."

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DEPARTMENT OF THE ENVIRONMENT

THE RELATIONSHIP BETWEEN LOCAL TAXES AND INCOME AND THE DISTRIBUTIONAL IMPACT OF THE COMMUNITY CHARGE

Local Taxes and Income

1. Figures 1-5 update the principal tables in Annex F of the Green Paper "Paying for Local Government" (Cmnd 9714) and supercede figures published on 13 January 1988. They have been prepared on an equivalent basis to the tables in the Green Paper except that they show the position for England rather than Great Britain; they have been prepared at 1988/89 price levels and incorporate the illustrative 1988/89 community charge figures published on 23 June. They incorporate current national tax rates and take account of the uprating of social security benefit announced for 1989/90.

2. The estimates have been made using sample information aggregated from the Family Expenditure Surveys of 1983, 1984 and 1985. There are 17,498 households in the sample. All the relevant information for those households has been brought forward to 1988/89 levels. While every effort has been made to ensure that these estimates give a fair description of the present situation and the likely future outcome, by the nature of the exercise, there are limits to the confidence which can be placed on their precision.

Domestic Rates

3. Figure 1 shows average domestic rate bills over ranges of net income, before and after rebates; in cash and as a percentage of net income. Before and after rebates, rate bills increase in cash as net household incomes rise. But even after rebates, households in the lowest income band have net rate bills of, on average, 3.9% of their net income. This compares to 2.3% for households with net weekly incomes of £500 or more. The effect of rebates, is to make net rates mildly progressive for the 4 lowest income bands. But households with incomes above £200 pw, on average, have rate bills which are smaller as a percentage of net income, than those with incomes below that.

4. The regressive nature of domestic rates can be partly explained by the relationship between rateable values and incomes. Figure 2 shows the ratio of average annual rateable values to average weekly net income. This ratio falls as net income rises. Households with a net weekly income of less than £50 have rateable values 6 times greater as a proportion of net income than those households in the highest income range.

5. Figure 3 shows the variations in rateable values within each income range. For those households with net incomes of less than £50 a week, 1 in 5 have rateable values of more than £200 (just above the average rateable value for the whole sample). Nearly 1 in 3 of those households in the highest income range have rateable values of less than the average. Overall, 41% of all households in England living in homes with rateable values above the average, have below average incomes.

The Community Charge System

6. The community charges paid by households will rise as household incomes rise (see Figure 4). Since the community charge will be collected from each adult, the rise in charges reflects the higher net income of households containing more adults. As with rates, the system of rebates reduces the community charge as a percentage of net income; from 10.9% to 3.0% in the lowest income band. Similarly, rebates cause the community charge to be progressive for incomes up to £150 per week.

7. It can be seen that over all households, community charges represent a slightly smaller proportion of net income than domestic rates, reflecting an increase in housing benefit entitlements. Net community charges represent a lower percentage of net income for households in all but one middle income band. Even in that band the net community charge as a percentage of net income is the same as under the domestic rate system. This reflects the average position for each income band. There are of course variations within these bands which are dealt with in the next section.

Figure 1: Relationship of gross and net rates to net household income. (England 1988/89 prices)

	Ranges of net household income (£pw)											
	Under 50	50-75	75-100	100-150	150-200	200-250	250-300	300-350	350-400	400-500	500+	All Households
Rate bills												
Gross £pw	6.43	6.80	7.50	7.83	8.51	9.10	9.97	10.66	11.51	12.45	15.41	8.76
Net £pw	1.72	2.67	4.37	6.46	8.13	8.94	9.88	10.62	11.49	12.42	15.40	7.36
As a % of net income in each range												
Gross	14.4	10.7	8.6	6.3	4.9	4.1	3.6	3.3	3.1	2.8	2.3	4.6
Net	3.9	4.2	5.0	5.2	4.6	4.0	3.6	3.3	3.1	2.8	2.3	3.8

Figure 2: Relationship between rateable value and income. (England 1988/89 prices)

	Ranges of net household income (£pw)											
	Under 50	50-75	75-100	100-150	150-200	200-250	250-300	300-250	350-400	400-500	500+	All Households
Average rateable value - annual	140	145	160	169	183	197	218	236	256	283	358	191
Average rateable value/ average net household income (in weekly terms)	3.1	2.3	1.8	1.4	1.0	0.9	0.8	0.7	0.7	0.6	0.5	1.0

Figure 3: Percentage of households in each income range with rateable values in specified ranges. (England 1988/89 prices)

	Ranges of net household income (£pw)					
	Under 50	50-100	100-200	200-300	300+	All Households
Ranges of rateable values (£s)						
0-50	10	3	1	0	0	2
50-100	26	18	14	8	4	12
100-150	25	33	23	16	9	22
150-200	20	27	29	28	16	26
200-250	9	11	18	23	19	17
250-300	7	5	9	15	20	11
300-400	2	3	5	8	20	7
400+	1	0	1	2	13	3
	100	100	100	100	100	100
% of all households in each income band	3.7	24.6	33.4	22.0	16.5	100

Figure 4: Relationship of gross and net community charge to net household income. (England 1988/89 prices)

	Ranges of net household income (£pw)										
	Under 50	50-75	75-100	100-150	150-200	200-250	250-300	300-350	350-400	400-500	500+	All Households
Community charge												
Gross £pw	4.86	5.34	7.39	8.16	8.98	9.72	10.15	11.00	11.25	12.19	12.81	8.66
Net £pw	1.34	2.05	3.49	5.82	7.95	9.02	9.63	10.45	10.78	11.61	12.24	6.86
As a % of net income in each range												
Gross	10.9	8.4	8.4	6.6	5.1	4.3	3.7	3.4	3.0	2.8	1.9	4.5
Net	3.0	3.2	4.0	4.8	4.5	4.0	3.5	3.2	2.9	2.6	1.9	3.6

Figure 5: Comparison of net domestic rates and community charges as a percentage of net incomes. (England 1988/89 prices)

	Ranges of net household income (£pw)											
	Under 50	50-75	75-100	100-150	150-200	200-250	250-300	300-350	350-400	400-500	500+	All Households
Domestic Rates as a % net income in range	3.9	4.2	5.0	5.2	4.6	4.0	3.6	3.3	3.1	2.8	2.3	3.8
Community Charge as % net income in range	3.0	3.2	4.0	4.8	4.5	4.0	3.5	3.2	2.9	2.6	1.9	3.6

The Distributional Impact of Changes to Local Taxation and Grant

8. The Local Government Finance Act provides for the community charge to replace domestic rates in England in 1990/91. In the first year of the new system a safety net has been proposed which will adjust grant payments so that the amount collected in each area, in the first year of the new system, is broadly the same as would have been needed had domestic rates still been in place. This safety net is to be phased out in equal instalments over the following three years.

9. The distributional effects for households and tax units (the term tax unit refers to an income tax unit, which is either a married couple or a single person who may form part of a larger household) of the introduction of the community charge have been analysed on two bases:

(a) the effect in the first year of the community charge system, with a safety net. (Figures 6-8)

(b) the effects when the community charge system is fully in place and the safety net has been unwound. (Figures 9-11).

10. In both cases community charges and domestic rates are assumed to be at the level needed to finance 1988/89 local authority spending levels. No account is taken of other changes due to come into force in 1990/91 - such as the proposed new financial regime for local authority housing. Actual community charges will depend in large part on the spending decisions of local authorities between now and 1990. The community charge figures used here are the illustrative figures published on 23 June 1988, but without dual running in Inner London.

11. As can be seen in Figure 6, in all regions over half of households pay less as a result of the introduction of the community charge, with a safety net: 57% of households in England would have experienced a change in their local rate/community

charge bill of less than £2 per week. For over 75% of households this change represents less than 2% of their net income.

12. Figure 7 shows there is a marked effect by household type. About 80% of households with three or more adults pay more while over 80% of single adult households pay less.

13. Figure 8 shows the pattern of gainers and losers by tax unit type. The principle difference between this and Figure 7 is that it breaks down the "3+ adult" households. It shows as losers single adults, who are members of multi-unit households and who will be meeting the cost of local services for the first time, (though they may live within a household which is gaining).

14. Figures 9-11 illustrate the position without the safety net. The pattern of gainers and losers by region is less even. This is because, under the present system, areas with below average rateable values generally receive more grant than areas with above average rateable values. This process of resource equalisation is intended to equalise rate poundages and is based on the premise that rateable values are a good indicator of ability to pay. The net result is that rate bills can vary widely between regions for the same standard of local services. With the community charge everybody should pay the same amount for equivalent levels of service.

15. Figure 9 shows that in England as a whole, 58% of households would be gainers. Households in the Northern and Yorkshire and Humberside regions are likely to have a preponderance of losers. Conversely households in the South East, East Anglia and the West Midlands are expected to show a preponderance of gainers.

16. Figure 10 shows the expected pattern of gainers and losers by household type. Single adult households gain (83% of single pensioners), two adult households have a small majority of gainers, and households with three or more adults preponderantly lose.

17. Figure 11 illustrates the same point for tax units. Over half would gain. The losers are concentrated in the "other single adult" category; those who will be drawn into paying for local services for the first time.

18. Figures 9-11 describe a position which will only be reached in practice by 1994/95. These illustrations, which are necessarily based on the assumption that local authority spending is unchanged from 1988/89, cannot be taken as a prediction of the eventual outcome.

FIGURE 6

IMPACT OF THE COMMUNITY CHARGE WITH SAFETY NETS (1990/91 POSITION: ENGLAND)

Number of Gainers and Losers: Thousands of Households

	Northern ('000s)	Yorks & Humberside ('000s)	North Western ('000s)	East Midlands ('000s)	West Midlands ('000s)	East Anglia ('000s)	Greater London ('000s)	South East ('000s)	South Western ('000s)	England ('000s)
POUNDS PER WEEK										
LOSERS										
10+	5	15	20	20	20	5	35	55	15	185
5-10	80	115	160	95	95	35	140	225	75	1015
2-5	205	300	265	220	250	100	330	555	230	2455
1-2	100	150	190	145	185	75	235	375	140	1595
0-1	240	390	420	285	310	155	370	490	295	2955
Total Losers	625 45%	970 44%	1055 41%	765 46%	860 40%	365 43%	1110 45%	1695 42%	755 44%	8205 43%
GAINERS										
0-1	380	560	655	370	495	185	500	690	385	4200
1-2	130	215	300	185	245	105	310	455	185	2130
2-5	170	285	360	230	355	125	400	680	270	2880
5-10	70	130	180	100	155	50	135	395	100	1315
10+	15	40	40	30	45	15	35	130	20	365
Total Gainers	770 55%	1230 56%	1525 59%	915 54%	1290 60%	475 57%	1380 55%	2355 58%	960 56%	10910 57

	Northern ('000s)	Yorks & Humberside ('000s)	North Western ('000s)	East Midlands ('000s)	West Midlands ('000s)	East Anglia ('000s)	Greater London ('000s)	South East ('000s)	South Western ('000s)	England ('000s)
PERCENTAGE OF NET INCOME										
LOSERS										
10+	0	0	0	0	0	0	0	0	0	0
5-10	0	10	10	5	5	0	15	20	0	60
2-5	135	215	210	165	170	60	170	300	130	1555
1-2	165	265	280	180	210	90	300	505	205	2210
0-1	325	485	555	415	475	210	625	870	420	4380
Total Losers	625	970	1055	765	860	365	1110	1695	755	8205
GAINERS										
0-1	395	620	700	410	550	220	625	1000	480	4990
1-2	200	300	420	260	355	140	390	640	230	2930
2-5	150	255	345	210	320	100	305	580	210	2480
5-10	25	45	50	35	60	15	55	115	35	435
10+	0	10	10	5	10	5	10	20	5	75
Total Gainers	770	1230	1525	915	1290	475	1380	2355	960	10910

Note: Figures are rounded to nearest 5,000

DOC25LP

FIGURE 7

IMPACT OF THE COMMUNITY CHARGE WITH SAFETY NETS (1990/91 POSITION: ENGLAND)

Thousands of Gainers and Losers : Household Types

	Single pensioner	Other single adult	Two Adults	Three + adults	All Households
POUNDS PER WEEK					
LOSERS					
10+	0	0	5	175	185
5-10	0	10	300	705	1015
2-5	15	145	1655 10.5%	645 62.5%	2455
1-2	45	175	1120	250	1595
0-1	330	360	2100	165	2955
Total Losers	385	685	5185	1945	8205
GAINERS					
0-1	1405	880	1810	125	4220
1-2	475	425	1110	110	2130
2-5	410	720	1580	170	2880
5-10	250	370	635	65	1315
10+	50	60	230	25	365
Total Gainers	2590	2455	5370	495	10910
PERCENTAGE OF NET INCOME					
LOSERS					
10+	0	0	0	0	0
5-10	5	15	35	5	60
2-5	25 1%	120 10.5%	800 7.9%	615 25%	1555 8.4%
1-2	45	195	1265	700 54%	2210
0-1	315	360	3085	620	4380
Total Losers	385	685	5185	1945	8205
GAINERS					
0-1	965	800	2940	285	4990
1-2	680	665	1450	140	2930
2-5	685	815	910	70	2480
5-10	220	150	60	5	435
10+	40	20	10	0	75
Total Gainers	2590	2455	5370	495	10910

Note: Figures are rounded to nearest 5,000

DOC26LP

IMPACT OF THE COMMUNITY CHARGE WITH SAFETY NETS (1990/91 POSITION: ENGLAND)

Thousands of Gainers and Losers: Tax Unit Types*

	Single Adults			Couples				
	Single pensioner	One Parent family	Other single adult	no children	1 child	2 children	3+ children	ALL TAX UNITS
POUNDS PER WEEK								
LOSERS								
10+	0	0	0	10	5	5	0	25
5-10	40	10	1215	215	70	55	15	1615
2-5	160 5%	20 3.6%	2910 47%	1005 19%	335 21%	300 16%	120 16.2%	4850
1-2	180	20	690	665	215	205	70	2045
0-1	515	80	1100	1205	355	380	180	3815
Total Losers	895	130	5910	3100	985	940	390	12350
GAINERS								
0-1	1425	305	655	1130	295	355	145	4310
1-2	505	115	415	670	195	285	70	2250
2-5	795	175	1095	945	325	400	125	3855
5-10	340	85	565	380	130	195	70	1765
10+	70	15	85	145	35	70	30	450
Total Gainers	3130	695	2820	3270	980	1300	435	12630

79.6%/all tax units.

	Single pensioner	One Parent family	Other single adult	no children	1 child	2 children	3+ children	ALL TAX UNITS
PERCENTAGE OF NET INCOME								
LOSERS								
10+	0	0	35	5	0	0	0	35
5-10	100	0	2150	55	10	10	5	2325
2-5	255 8.8%	30 3.6%	3000 59.4%	555 9.65%	175 9.4%	130 6.25%	45 6.1%	4185?
1-2	210 14%	60 11%	345 63%	795 22%	225 21%	220 16%	80 15%	1940
0-1	325	40	385	1695	575	585	255	3860
Total Losers	895	130	5910	3100	985	940	390	12350
GAINERS								
0-1	980	285	605	1665	530	730	245	5040
1-2	700	170	650	855	260	355	125	3110
2-5	775 36%	180	1060 18%	640	170	200	65	3095
5-10	575	50	390	90	15	10	5	1130
10+	100	5	115	25	5	0	0	250
Total Gainers	3130	695	2820	3270	980	1300	435	12630

Note: Figures are rounded to nearest 5,000

* The term tax unit refers to an income tax unit, which is either a married couple or single person. Tax units which do no contain a person aged 18 or over are excluded from the figures - they would gain or be unaffected by community charge.

DOC27LP

FIGURE 9

IMPACT OF THE FULL COMMUNITY CHARGE WITH NO SAFETY NETS (ENGLAND)

Number of Gainers and Losers: Thousands of Households'

	Northern ('000s)	Yorks & Humberside ('000s)	North Western ('000s)	East Midlands ('000s)	West Midlands ('000s)	East Anglia ('000s)	Greater London ('000s)	South East ('000s)	South Western ('000s)	England ('000s)
POUNDS PER WEEK										
LOSERS										
10+	35	50	40	25	5	5	135	10	10	3[illegible]
5-10	165	250	180	120	45	20	225	100	75	11[illegible]
2-5	265	365	270	215	170	80	285	335	220	22[illegible]
1-2	110	220	210	155	125	55	225	220	130	144
0-1	275	435	435	265	265	140	310	415	275	282
Total Losers	850	1325	1130	780	610	295	1185	1080	710	797
GAINERS										
0-1	295	420	590	340	505	180	445	725	395	38[illegible]
1-2	80	155	285	205	315	115	275	490	185	21[illegible]
2-5	115	180	355	225	430	155	385	905	290	30[illegible]
5-10	50	95	180	100	220	70	160	625	115	16[illegible]
10+	10	30	40	30	75	15	40	230	25	4[illegible]
Total Gainers	550	875	1450	900	1540	545	1305	2970	1010	111[illegible]
PERCENTAGE OF NET INCOME										
LOSERS										
10+	0	0	0	0	0	0	5	0	0	
5-10	15	40	10	5	0	0	120	5	0	1[illegible]
2-5	265	400	265	200	85	35	330	120	125	18[illegible]
1-2	210	350	290	190	140	70	245	275	190	19[illegible]
0-1	360	530	565	385	385	190	480	675	395	39[illegible]
Total Losers	850	1325	1130	780	610	295	1185	1080	710	79[illegible]
GAINERS										
0-1	290	460	645	410	550	225	605	1030	480	46[illegible]
1-2	125	200	415	245	480	170	335	860	260	30[illegible]
2-5	115	185	315	210	415	130	295	870	220	27[illegible]
5-10	15	25	65	30	80	20	60	180	40	5[illegible]
10+	0	5	10	5	10	5	10	30	5	
Total Gainers	550	875	1450	900	1540	545	1305	2970	1010	111[illegible]

Note: Figures are rounded to nearest 5,000

DOC28LP

IMPACT OF THE FULL COMMUNITY CHARGE WITH NO SAFETY NETS (ENGLAND)

Thousands of Gainers and Losers : Household Types

	Single pensioner	Other single adult	Two Adults	Three + adults	All Households
POUNDS PER WEEK					
LOSERS					
10+	0	0	80	230	310
5-10	5	50	545	590	1185
2-5	30	165	1430	580	2205
1-2	50	190	965	240	1445
0-1	405	390	1835	190	2820
Total Losers	490	795	4855	1825	7970
GAINERS					
0-1	1330	805	1600	155	3885
1-2	445	420	1130	120	2110
2-5	385	625	1815	215	3040
5-10	255	430	835	90	1610
10+	70	70	315	40	495
Total Gainers	2485	2350	5700	615	11145
PERCENTAGE OF NET INCOME					
LOSERS					
10+	0	5	5	0	15
5-10	5	30	105	50	195
2-5	45	165	1010	610	1830
1-2	80	210	1125	545	1965
0-1	360	385	2605	615	3965
Total Losers	490	795	4855	1825	7970
GAINERS					
0-1	860	755	2745	340	4695
1-2	670	595	1645	185	3095
2-5	655	805	1210	90	2760
5-10	260	160	85	5	510
10+	45	25	10	0	80
Total Gainers	2485	2350	5700	615	11145

Note: Figures are rounded to nearest 5,000

DOC29LP

IMPACT OF THE FULL COMMUNITY CHARGE WITH NO SAFETY NETS (ENGLAND)

Thousands of Gainers and Losers: Tax Unit Types*

	Single Adults			Couples				
	Single pensioner	One Parent family	Other single adult	no children	1 child	2 children	3+ children	ALL TAX UNITS
POUNDS PER WEEK								
LOSERS								
10+	0	0	65	65	15	10	0	165
5-10	35	15	1165	340	125	100	40	1815
2-5	195	20	2995	865	300	280	95	4750
1-2	180	30	800	560	190	190	55	2005
0-1	600	105	975	1085	270	325	170	3535
Total Losers	1010	170	6005	2910	905	910	360	12270
GAINERS								
0-1	1340	280	620	990	255	270	130	3885
1-2	470	115	405	665	215	240	80	2195
2-5	765	155	995	1100	365	480	140	3990
5-10	345	90	600	525	170	240	80	2050
10+	90	20	100	185	55	95	40	590
Total Gainers	3015	655	2725	3465	1060	1330	465	12710
PERCENTAGE OF NET INCOME								
LOSERS								
10+	5	0	80	10	0	0	0	90
5-10	100	0	2115	105	25	10	5	2365
2-5	255	35	3055	670	205	190	60	4465
1-2	275	60	385	665	245	200	75	1900
0-1	380	75	370	1460	430	515	220	3450
Total Losers	1010	170	6005	2910	905	910	360	12270
GAINERS								
0-1	870	265	595	1575	515	575	230	4625
1-2	685	155	565	930	300	465	130	3230
2-5	750	170	1045	820	225	275	100	3390
5-10	595	55	400	110	15	15	5	1200
10+	110	10	120	25	5	0	0	270
Total Gainers	3015	655	2725	3465	1060	1330	465	12710

Note: Figures are rounded to nearest 5,000

* The term tax unit refers to an income tax unit, which is either a married couple or single person. Tax units which do not contain a person aged 18 or over are excluded from the figures - they would gain or be unaffected by community charge.

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FROM: MISS M P WALLACE
DATE: 5 January 1989

PS/CHIEF SECRETARY

cc PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Mr Monck
Mr Phillips
Mr Luce
Mr Odling-Smee
Mr Sedgwick
Mr Spackman
Mrs Butler
Mrs Brown
Mr Gieve
Mr MacAuslan
Mr Hansford
Mr Mowl
Mr Potter
Mr Richardson
Miss Walker
Mr Call
Mr Tyrie

1988 PUBLIC EXPENDITURE SURVEY POST MORTEM

The Chancellor has seen Mr MacAuslan's postmortem on the 1988 Survey, which he thought a very good paper.

2. He has noted the comment in paragraph 3.10 that from 1990 the measured level of money GDP will be about 1¼ percentage points lower, because "whereas local authority rates are classified as an expenditure tax adding to GDP at market prices, it has been decided that the community charge will not be so classified". The Chancellor does not recall this decision having been taken, nor does he see how it can be taken in advance of the decision about the treatment of the community charge in the RPI. Furthermore, the consequences for GDP, and the GGE:GDP ratio appear somewhat

absurd. He would be grateful for a further note on this classification issue. I should be grateful if Mr Sedgwick could provide.

MOIRA WALLACE

cm/min/030 CONFIDENTIAL

FROM: COLIN MOWL
DATE: 24 January 1989

1. SIR T BURNS

2. CHANCELLOR

I see no way round this; the community charge is clearly not a tax on expenditure. We should give our attention to the presentational problems it causes.

TB.

Ch
Pretty major ramifications.
Word with Terry & Peter @ forecast meeting tomorrow?
AA

Yes. / discuss.

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Mr Wicks
Mr Scholar
Mr Phillips
Mr Byatt
Mr Sedgwick
Mr Riley
Mr Culpin
Mrs Lomax
Mr Edwards
Mr R I G Allen
Mr Potter
Mr MacAuslan
Mrs Butler
Mr S J Davies
Mr S W Matthews
Mr Hibberd
Mr Owen

CLASSIFICATION OF THE COMMUNITY CHARGE IN THE NATIONAL ACCOUNTS

Mr MacAuslan's post-mortem on the 1988 Survey said that from 1990 the measured level of money GDP will be about 1¾ percentage points lower, because "whereas local authority rates are classified as an expenditure tax adding to GDP at market prices, it has been decided that the community charge will not be so classified". Miss Wallace's minute of 5 January asked for a note on this.

2. This minute deals only with the implication of the introduction of the community charge for the national accounts. Wider issues on the presentation of policy, including implications for the MTFS, GGE ratios, tax burden etc will be dealt with separately by Mr Riley in consultation with GEP and other interested divisions.

3. National accounts classification issues are largely a matter for the CSO, although the Treasury is usually consulted on major issues, as we were on this occasion. The treatment of the community charge in the national accounts was discussed at a meeting of the CSO's inter-departmental committee on economic statistics (CSO(E)) in October. The meeting was chaired by Jack Hibbert and I represented the Treasury.

4. We had discussed in advance with Sir Terence Burns what our attitude should be. Our main concern was to ensure that the national accounts treatment was "correct". We took the view that whatever else it was the community charge was not a tax on expenditure or indirect tax. It would not like LA rates - which are an indirect tax on housing - be part of market price GDP. Nevertheless we would have preferred CSO(E) to have deferred a decision until the treatment of the community charge in the RPI had been decided. The two decisions - how to treat the community charge in the RPI and GDP - do not depend on the same considerations, but we wanted to avoid the possibility of a CSO decision on the national accounts having excessive influence on the RPI discussion. But we were not able to persuade the rest of CSO(E) that this should be a consideration.

5. As you know the **RPIAC** has now decided to recommend inclusion of the community charge in the RPI, but its justification for doing so is vague. However it is clear that the justification is not that it is an indirect tax. Moreover none of the alternative arguments put forward at the RPIAC, either for or against inclusion of the community charge in the RPI, would imply that the community charge should be treated as an expenditure tax in the national accounts.

6. The CSO argued that the community charge should be treated as a tax in the **national accounts.** We supported this view. The DOE on the other hand, alone among the departments represented, disagreed. (The arguments are set out in full in the attached annex.) In face of this strongly held DOE position, and in view of the difficulty of fitting the community charge into the existing categories of tax - as well as not being a tax on expenditure, neither is it a tax on income nor on capital - CSO(E) decided that the community charge should not be classified formally as a tax in the national accounts but should be shown separately ie. not included in any of the existing classes of receipts. As long as it is accepted that the community charge is not a tax on expenditure (and no department disputed this) the implications for GDP described in the following paragraphs inevitably follow, whichever of the options for classification of the community charge is adopted.

7. The introduction of the community charge will not affect any of the measures of GDP at factor cost. It will not therefore distort figures for economic growth which in the UK are invariably based on factor cost measures.

8. GDP at market prices can be defined as GDP at factor cost plus taxes on expenditure less subsidies. With the abolition of rates taxes on expenditure will be lower than they would otherwise have been, as will GDP at current market prices. This will be true of all three measures of GDP - income, expenditure and output - and the average ie. money GDP as used in the MTFS, PEWP etc. We estimate that the level of money GDP will be reduced by under ¼ per cent in 1989-90 by the introduction of the community charge in Scotland and by about 1¾ per cent in 1990-91 following its introduction in England and Wales. (These estimates assume that the same amount of revenue is raised, whether from rates or community charge.) This effect is inevitable as long as the community charge is not defined as a tax on expenditure.

Saving us how much?

9. GNP at market prices, which is at present used to calculate EC contributions, will also be affected.

10. There will also be some effects on the personal sector statistics. Rates are counted as expenditure on housing and are included in the figures for consumers' expenditure. Community charge will be treated as a deduction from personal sector gross income before striking personal disposable income. Introduction of the community charge will therefore reduce the growth of both consumers' expenditure and personal disposable income at current prices, by about 2½ per cent in 1990-91. These have offsetting effects on saving which is unchanged. The saving ratio however will be very slightly higher (by less than 0.1) because its denominator, personal disposable income, is lower.

11. Although consumers' expenditure at current market prices will be lower, consumers' expenditure at constant prices will be unchanged. This implies that the consumers' expenditure deflator (and GDP deflator) will be lower. The abolition of domestic rates will not affect the amount or volume of housing services consumed, rather it will reduce the price paid for those services. Hence the

consumers' expenditure deflator is lower. Another way of looking at this is to imagine what would happen were rates to be increased substantially rather than abolished. In this case there would be an increase in consumer prices.

12. The estimated effects are to reduce the growth of the consumers' expenditure and GDP deflators in 1990-91 by about 2½ per cent and 1¾ per cent respectively.

13. It follows that as the volume of consumers' expenditure will be unchanged, so will the volume of domestic demand and GDP.

14. The recent **Treasury Economic Forecast** (Mr Sedgwick's minute of 18 January) did not allow for these effects on GDP etc so as not to distort its policy implications. In other words community charge was treated as if it were a tax on expenditure. The table below shows the effect on forecast money GDP growth, the GDP deflator, GGE ratios and tax burden of treating community charge in the way decided by the CSO.

	1988-89	1989-90	1990-91
Money GDP growth - %			
Forecast report	11.1	7.3	6.3
Adjusted for proposed treatment of community charge	11.1	7.1	4.7
GDP deflator growth - %			
Forecast report	7.0	5.8	4.5
Adjusted for proposed treatment of community charge	7.0	5.6	2.9
GGE (excl. privatisation proceeds ratio - %			
Forecast report	39.4	39.1	39.2
Adjusted for community charge	39.4	39.1	39.8
Non-oil tax burden* - %			
Forecast report	37.2	37.5	37.7
Adjusted for community charge	37.2	37.5	38.3

* before fiscal adjustment

Colin Mowl

COLIN MOWL

ANNEX

The treatment of taxes (including rates) in the National Accounts

1. In the national accounts government revenues are divided into three categories:

(i) **taxes**;

(ii) **charges** for services provided ie. where the government is operating rather like a commercial enterprise;

(iii) **other transfers** to the government which are neither taxes nor charges for services provided - for example national insurance contributions and passport fees.

2. Taxes are divided into current and capital taxes and the former are further divided into taxes on income and taxes on expenditure. No precise, formal definitions for these categories underpin the UK national accounts but we broadly follow international conventions. According to these:

- a **tax** is a compulsory, unrequited (ie. not given in return for something), non-repayable payment to government. It includes fees and charges levied by government which are either out of all proportion to the costs of providing the service, licencing the activity etc or where the payer does not receive benefits in proportion to payments.

- **charges** are payments to government for specific goods and services provided to the individual paying the charges. There should be a clear and direct link between the payment of the charge and the acquisition by the payer of specific goods and services. The charges should be optional in that there should be no compulsion to pay if the individual decides not to receive the goods or services concerned.

- there is no explicit definition of **other transfers**. They are simply transfers which do not fall into the other two categories. National insurance contributions, included here, are distinguished from general taxation because their payment gives rise to accrued rights for the payer.

3. **Local authority rates** are counted in the UK national accounts as a tax on expenditure. **Taxes on expenditure** are defined to be taxes which enter into costs of production and distribution, or taxes on final buyers associated with the purchase, possession or use of particular goods. The classification of rates as a tax on expenditure is justified on the basis of it being a tax on the production and supply of housing or other property services (whether by a landlord or owner occupier to him or herself). This justification is not entirely convincing and the classification could well not be the one we would adopt were we deciding it afresh.

Proposed treatment of community charge in the national accounts

4. There is no clear-cut home for the community charge within existing national accounts conventions. There is however a strong case, accepted by Treasury officials, for saying that it is a "tax" of some sort, despite its name:

- it is compulsory for all adult residents (with some minor exceptions) whether or not they avail themselves of the services provided by local authorities;

- it is unrequited, since the payments made do not bear a direct relationship to the services consumed by individual payers;

- it is a recurrent levy and not repayable (if services are not utilised, for example).

5. But there are no arguments, which we have been able to identify, for considering the community charge a tax on expenditure. There is no related good or service to the production or use of which the payments are directly related. The payments must be made regardless of whether any benefit is received by the individual taxpayer of the services they are used to provide.

6. Nor can the community charge be considered a tax on income (although the charge is not completely independent of income because

some people below a certain "poverty" line will pay only 20 per cent of the full amount), nor a tax on capital.

7. The DOE argued that the community charge was not a tax. This may have been because a CSO decision to classify it as a tax, if it became known might, have jeopardised its inclusion in the RPI. Their substantive argument was that the charge should be classified as an "other current transfer" because, like national insurance contributions, payment of the charge gives rise to rights for the payer. In addition since the level of the charge payable in each area is related to the level of services (rather the inputs to those services) to which charge payers are entitled it could be argued that the level of payment is not unrequited and therefore should not be treated as a tax.

8. No other department supported this view. But as the community charge does not fit into the existing three-way classification of taxes, and faced with an entrenched DOE position, the committee decided to treat the community charge as a completely separate item of revenue ie. as neither a tax, nor "other current transfer", nor as a "charge". It was recognised however that this was not an entirely satisfactory solution and that it would be necessary to review it later (see paragraph 14 below).

<u>**Implications for money GDP**</u>

9. There are two different ways of valuing domestic or national product; at **market prices**, including all taxes on expenditure (with subsidies regarded as negative taxes), or at **factor cost**, representing only the sum of the incomes of factors of production. Although taxes on expenditure form part of producers' costs, they do not form part of the income of factors of production.

10. Both methods of valuation are used in different contexts. According to the UK official handbook on the national accounts "broadly the justification of market prices is that they represent the relative values to the individual of different goods and services, on the usual assumption that the price paid for each commodity is proportional to its marginal significance. Thus an increase in the domestic product at constant market prices, other things being equal, can be regarded as indicating prima facie an

increase in the 'economic welfare' of the community. On the other hand, valuation at factor cost displays the composition of national product or expenditure in terms of the factors of production employed, the contributions of the factors being measured by the incomes which they receive. Valuation at factor cost may therefore be useful in connection with problems of allocating resources. The choice between the two presentations thus depends on the purpose for which the statistics are to be used."

11. In the UK economic growth is normally measured by real GDP at factor cost. But MTFS objectives for money GDP are in terms of GDP at current market prices, and the Government's tax and expenditure objectives are expressed in terms of ratios to GDP at market prices.

12. Once it is accepted that the community charge is not a tax on expenditure a reduction in the market price measure of GDP is inevitable at the point the community charge replaces rates. The CSO estimated that this was worth 1¾ per cent off market price GDP. GDP at factor cost is however not affected.

13. As the table below shows the gap between the growth of GDP at factor cost and market prices in any one year has over the past 10 years been ½ per cent or less. The main exceptions, 1979-80 and 1981-82, are years in which there were unusually large increases in indirect taxes. Gaps will occur whether or not these were associated with tax switches, as in 1979-80, or net tax increases as in 1981-82. (In one sense the replacement of rates by community charge is just such a tax switch.)

Money GDP % increases

	1978-1979	1979-1980	1980-1981	1981-1982	1982-1983	1983-1984	1984-1985	1985-1986	1986-1987	1987-1988
Market prices	14.8	20.0	13.9	9.9	9.5	8.5	7.1	9.3	7.0	10.6
Factor cost	14.5	17.9	13.6	8.2	9.7	8.9	7.5	8.8	6.0	10.2
Difference	0.8	2.1	0.3	1.7	-0.2	-0.4	-0.4	0.5	1.0	0.4

Postscript on the future treatment of taxes in the national accounts

14. One option considered by CSO(E) is to change the current three way classification of taxes in the national accounts to a two way classification of <u>direct</u> and <u>indirect</u> taxes. The advantages of this would be first that it would be more consistent with the international conventions and secondly, were we able to agree that community charge is a tax, that community charge would have an obvious home in direct taxes. This option has been put on ice for the moment however, but not forgotten, because of the DOE's current opposition to treating the charge as any sort of tax and because the international conventions are themselves under review.

RP

FROM: A C S ALLAN
DATE: 30 January 1989

MR MOWL

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Scholar
Mr Phillips
Mr Byatt
Mr Sedgwick
Mr Riley
Mr Culpin
Mrs Lomax
Mr A J C Edwards
Mr R I G Allen
Mr Gieve
Mr Potter
Mr MacAuslan
Mrs Butler
Mr S J Davies
Mr Matthews
Mr Hibberd
Mr Owen

CLASSIFICATION OF THE COMMUNITY CHARGE IN THE NATIONAL ACCOUNTS

The Chancellor was grateful for your minute of 24 January. He noted the implications you described for money GDP, the GDP deflator, and various personal sector statistics.

2. He feels that we should not make these adjustments in the forecasts to be published in the FSBR. We shall - subject to further discussion - be including other adjustments to allow for the errors in the national accounts, and he feels that to introduce two sets of adjustments at one go would make the presentation very much more difficult. We may, however, need to include some sort of footnote to record that we have not made this adjustment.

ACSA

A C S ALLAN

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FROM: C J RILEY
DATE: 30 JANUARY 1989

CHANCELLOR

Thanks. I have considered carefully, but prefer Option B for the reasons set out in Mr Allan's minute of 30/1.

Ch
This crossed with my minute repeating the conclusion you had reached with Peter & Terry last week (favouring Option B).

AA

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Scholar
Mr Byatt
Mr Phillips
Mr Culpin
Mrs Lomax
Mr Peretz
Mr Sedgwick
Mr MacAuslan
Mrs Butler
Mr Davies
Mr Matthews
~~Mr Hibberd~~
Mr Mowl
Mr Savage
Mr. Gieve
Mrs Chaplin
Mr Tyrie
Mr Call

THE COMMUNITY CHARGE AND MONEY GDP IN THE FSBR

Colin Mowl's submission of 24 January considers the appropriate classification of the community charge in the national accounts, and how the statisticians propose to proceed. This paper considers some of the presentational issues which arise in the context of the FSBR.

2. The situation as regards the statistics is as follows. Whereas domestic rates are classified as an expenditure tax, adding to money GDP at market prices, it is intended not to classify the community charge in this way. The effect will be to produce a downwards distortion to the growth in money GDP and the GDP deflator in the next two years. The effect will be fairly small in 1989-90 when the charge is introduced in Scotland, but quite large in 1990-91 when it is introduced in England and Wales.

CONFIDENTIAL

Effects of the community charge on money GDP (%)

	1989-90	1990-91	Later years
Level	-¼	-1¾	-1¾
Growth rate	-¼	-1½	-

3. While the statisticians' decision cannot reasonably be disputed, it does pose a number of presentational issues in relation to the FSBR which we need to consider. It impacts on the presentation of policy in a number of ways:

(i) Money GDP is used to describe our medium term nominal objective in the MTFS (FSBR table 2.1, charts 2.1 and 2.3). Figures for the current year and the year ahead are presented in the economic forecast (table 3.12). It is also used to define the velocity of the monetary aggregates (chart 2.2) and the stance of fiscal policy (the PSBR is shown as a per cent of GDP in tables 2.6 and 6.1, charts 2.3 and 2.5).

(ii) The key public expenditure ratio is GGE (excluding privatisation proceeds) as a per cent of money GDP (table 5.1 and chart 6.1).

(iii) Measures of the tax burden use money GDP as the denominator (table 6.2 and chart 6.1).

(iv) The GDP deflator is used to define our medium term inflation aspiration in the MTFS (table 2.3). It is also used to define public expenditure in real terms (table 5.1).

4. The effects on these variables will not be uniformly helpful in presentational terms as we switch over to the community charge. And the recorded figures will give a misleading indication of underlying movements. The recorded money GDP growth rate will be depressed slightly in the next two years, implying faster progress towards our medium term objectives. But everybody will be aware that part of the deceleration is spurious. Furthermore, because

recorded money GDP is reduced, figures for the public expenditure ratios and the tax burden will be increased by nearly ¾ of a percentage point by 1990-91, probably causing the ratio to rise in that year.

5. The question arises: how should we handle this in the FSBR. There are three main options:

Option A

Present figures for money GDP at market prices as we expect them to be recorded by the CSO. We would have to explain that the figures were distorted by the change to the community charge, and give an indication of the scale of the effect in each case. Adjusted figures, correcting for the distortion, could be given in footnotes (or in brackets) and on charts as necessary.

Option B

This isn't quite how we'd put it: we'd say not yet taken a board change to CC.

Present money GDP figures as if the community charge were classified as an expenditure tax - the approach used in the January forecast - to give an undistorted series. (A less satisfactory alternative would be to take rates out of the data for the years up to 1989-90, bringing them into line with the figures for 1990-91 onwards). We would probably have to set out the estimated effects of the community charge; and we would have to acknowledge in footnotes that in the FSBR it had been classified in the same way as rates.

Option C

A more radical option would be to move to the factor cost definition of money GDP. The data for this will not be distorted by the move to the community charge, and in normal circumstances the growth rate is very similar to the market price definition (see chart 1). The main impact would be on the public expenditure and tax ratios; the factor cost definition of GDP is about 15% lower than the market price definition, raising the expenditure and tax ratios by around 6 points (see charts 2 and 3).

Assessment

6. Moving to the factor cost definition - option C - can probably be dismissed fairly quickly. While this option might not pose serious difficulties for the MTFS, it would have a major impact on the expenditure and tax ratios. The market price definition was chosen in the late 1970s largely because it yields lower numbers for these ratios. Moving to the factor cost definition - and ratios of the order of 45% - would be presentationally very awkward. It would be very difficult to justify a major shift of presentation on the grounds of a temporary distortion to our present definition.

7. The approach adopted in the January forecast - option B - has the virtue of simplicity. But it could only be a temporary expedient; we would eventually have to adhere to the CSO convention, probably in the Autumn Statement. And departing from agreed statistical conventions in order to produce an undistorted series might attract criticism. This is not the first time that the path of money GDP has been distorted. The reverse phenomenon occurred in 1979-80 as the pattern of taxation was shifted from direct to indirect, raising the recorded growth of money GDP, and depressing the measured tax and expenditure ratios. We did not make any adjustments on that occasion, and to do so now might be difficult to justify. Although the 1979-80 episode was in some respects different from the present one - there was a genuine change in the price level, for example - it raised similar issues about the difference between underlying and recorded changes.

8. It is unclear whether the proposed CSO treatment will be public knowledge by the time of the Budget. It might only emerge when the second quarter figures, incorporating the Scottish community charge for the first time, are published in September. But it may well come to light sooner; publication of the RPI Advisory Committee Report in February or March may provoke questions from informed commentators. We clearly cannot rely on it not being public knowledge on or soon after Budget day.

9. It might be argued that we could get away with departing from the CSO convention for this Budget because the effect on 1989-90 is not very great. But we should remember that we may well be presenting national accounts figures which differ in a major way from those published by the CSO - see Jim Hibberd's submission of 26 January. To adopt a different definition for money GDP as well risks adding unnecessarily to the impression that we were cooking the books.

cuts both ways

10. Option A - sticking with the CSO convention - would involve a certain amount of complication, affecting a range of variables throughout the FSBR. For example, additional rows would be needed in tables 1.2, 6.7 and possibly 6.5, which set out the public sector's finances, but this would be no problem. The extra complication with option A is certainly manageable.

11. One merit of this option is that it would permit our figures to be compared with the published data as they emerge; this may not be a major issue in 1989-90, but it would be in 1990-91. And it would avoid providing commentators with an extra line of attack on our handling of the statistics. It does not preclude our indicating in the FSBR the underlying movements in key variables; indeed, this would be essential.

No published figures will probably be 'undistorted'

12. Our recommendation is to go for option A. Option B would merely postpone the problem until the Autumn Statement. We will have to adopt option A sooner or later, and there may be little advantage - indeed there would be some risks - in delay. Implications for the GGE ratios using the conventions underlying the MTFS are shown in an annex.

13. You may wish to discuss this issue at your meeting on the MTFS on Wednesday.

CJR

C J RILEY

ANNEX

General Government Expenditure as a per cent of GDP

	1988-89	1989-90	1990-91	1991-92
Option A				
Total	37.9	38.2	38.7	38.5
Excl. privatisation	39.4	39.2	39.6	39.4
Option B				
Total	37.9	38.2	38.0	37.8
Excl. privatisation	39.4	39.2	38.9	38.7

Assumptions

Money GDP path as recommended in table 3 of MP1 paper on MTFS Issues (27 January).

GGE in cash terms as in the January forecast for 1988-89. Autumn Statement figures from 1989-90 onwards.

Chart 1. Gross domestic product annual growth rate

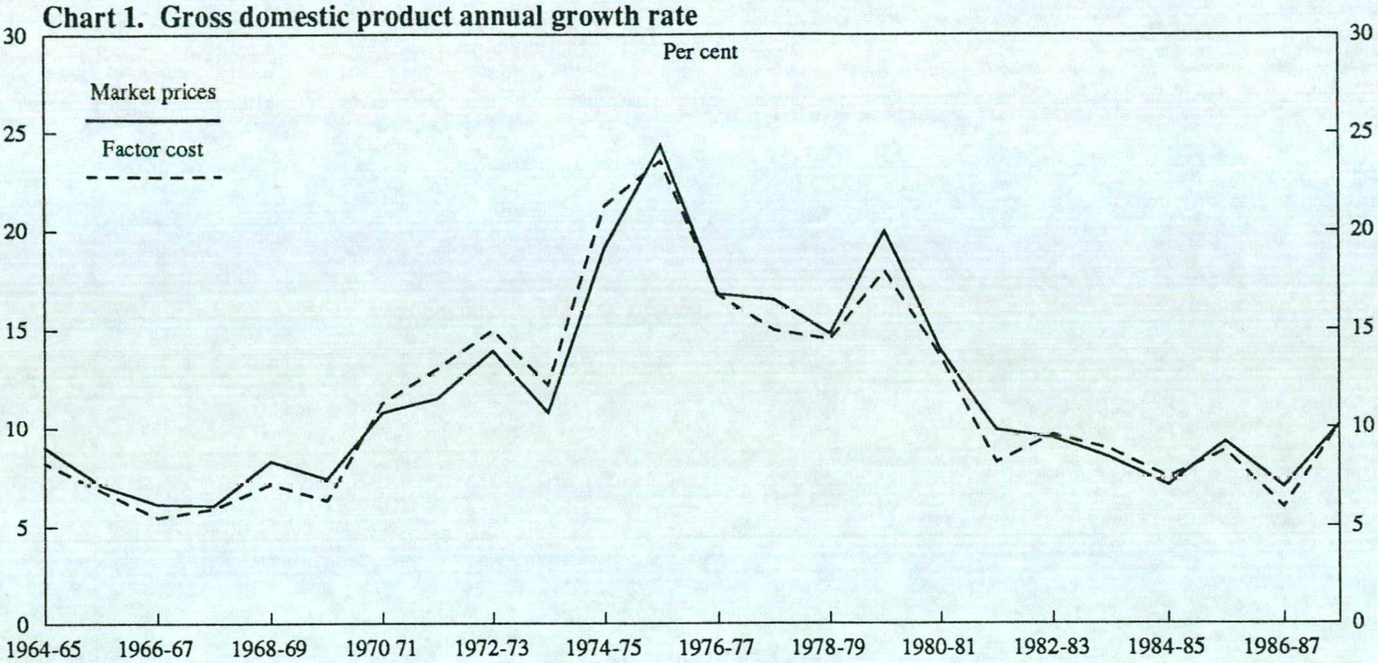
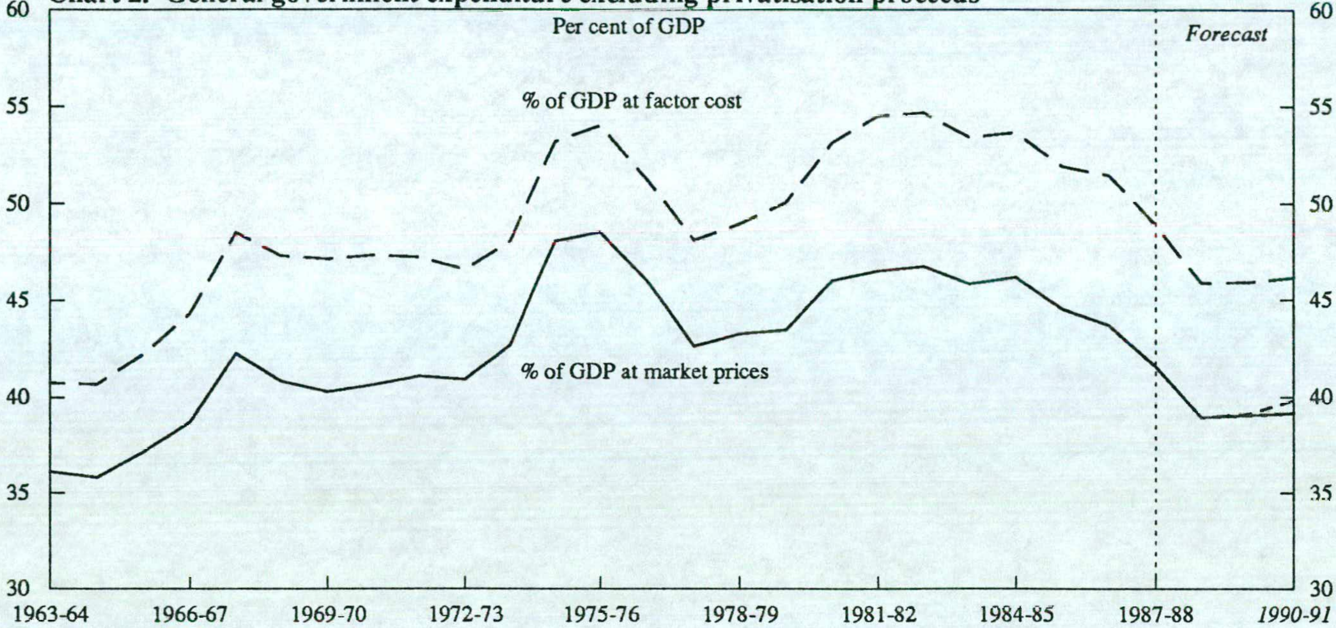


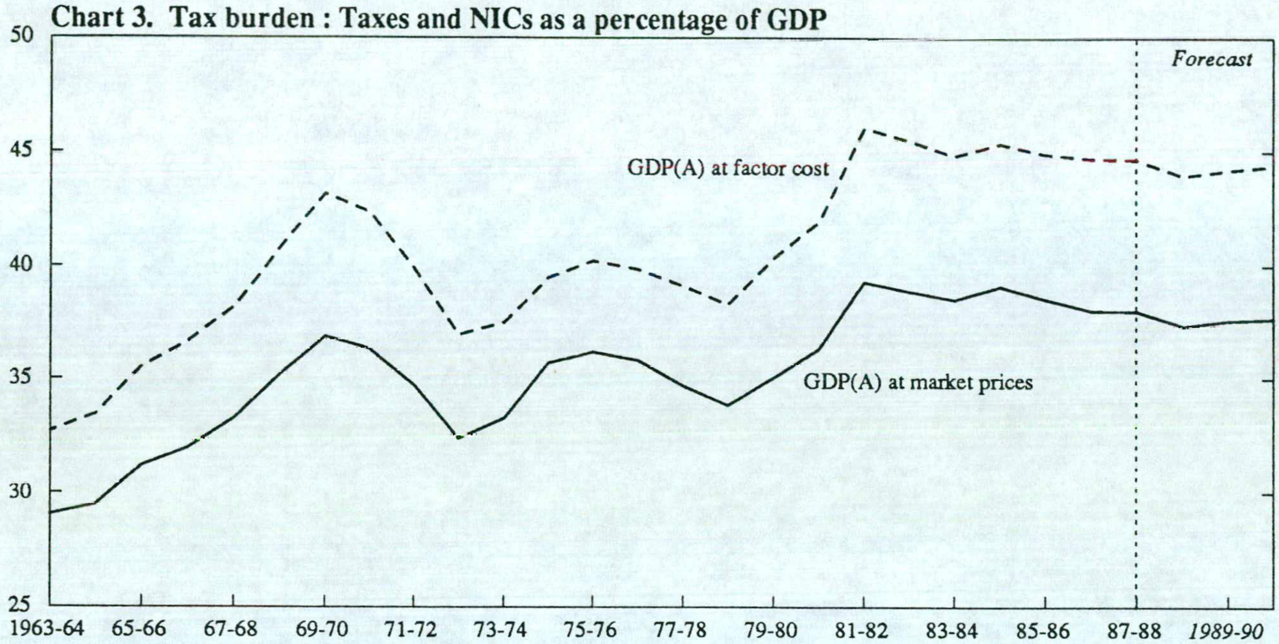
Chart 2. General government expenditure excluding privatisation proceeds



——— *- Treats community charge as a tax on expenditure*

- - - - - *- Community charge not treated as a tax on expenditure*

Chart 3. Tax burden : Taxes and NICs as a percentage of GDP



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FROM: A C S ALLAN
DATE: 31 January 1989

MR C J RILEY

PWP

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Scholar
Mr Byatt
Mr Phillips
Mr Culpin
Mrs Lomax
Mr Peretz
Mr Sedgwick
Mr MacAuslan
Mrs Butler
Mr Davies
Mr Matthews
Mr Hibberd
Mr Mowl
Mr Savage
Mr Gieve
Mrs Chaplin
Mr Tyrie
Mr Call

Ch
Rachel wants to re-open this @ this afternoon's meeting [Largely I think so that ratios get humped up before her first Survey?!]

AA

THE COMMUNITY CHARGE AND MONEY GDP IN THE FSBR

The Chancellor was grateful for your minute of 30 January. Having considered the issues carefully, he prefers Option B (ie not making any adjustments for the introduction of the community charge in the FSBR), for the reasons set out in my minute of 30 January to Mr Mowl, namely that introducing both adjustments for the community charge and adjustments for the errors in the national accounts at one go would make the presentation very much more difficult.

ACSA

A C S ALLAN

RPIAC

PS/CON/26 CONFI

CH/EXCHEQUER
REC. 27 FEB 1989
ACTION MR SEDGWICK
COPIES TO SIR P MIDDLETON
SIR T BURNS
MR ANSON
MR SCHOLAR
MR PERETZ
MR EDWARDS
MS WHELDON - T/SOL

Department of Employment
Caxton House, Tothill Street, London SW1H 9NF

Telephone 01-273 . 5803 . .
Telex 915564 Fax 01-273 5821

Secretary of State

a
As expected.
Advice will be
coming up on detail
AA

V. important that our acceptance of these be given firm & emphatic, & does not include RTS markets.

The Rt Hon Nigel Lawson
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1

February 26

Dear Nigel

RETAIL PRICES INDEX ADVISORY COMMITTEE REPORT

I have now received the Advisory Committee's report on the Community Charge issue, and have announced that I intend to publish it shortly, together with my decision on the recommendations. Printing arrangements have been put in hand which would allow publication as a Command Paper on Friday 3 March, on which day I hope to make a substantive announcement by means of an Arranged PQ, with an accompanying Press Notice from my Department.

I enclose a copy of the report, whose main recommendation is that the Community Charge should be included in the RPI in future in a similar way to that in which rates are included at present. I understand that this conclusion was reached by consensus amongst the non-Government members of the Committee, who represent consumers and employees, retailers, business interest and the academic community. As we had agreed, officials representing Government Departments avoided expressing strong preferences on the issues before the Committee. However, the conclusion reached by the Advisory Committee seems likely to be acceptable in all the circumstances, and likely to command greater public acceptance than the alternative of excluding the Charge from the Index.

Though the Committee is only advisory, its recommendations have never been rejected in the past and my view is that we should accept them on this occasion. The arguments for including the Community Charge in the RPI, and, indeed, the

Employment Department · Training Agency
Health and Safety Executive · ACAS

Secretary of State
for Employment

contrary case, are set out at some length in the report. It is precisely because the matter is a difficult one, which cannot be easily resolved on technical grounds, that we need the seal of approval which a recommendation from an independent body gives. In the past this has provided a good defence against criticism of the methodology followed in compiling the Index. It is helpful that the arguments both for and against inclusion have been set out so fully in the attached report. Nevertheless, there is a clearly stated consensus in favour of inclusion.

You know of the need for early publication, and since your officials have been involved in the discussions throughout, I now seek your early comments (and those of Nicholas Ridley, John Moore and Malcolm Rifkind, to whom I am copying this), by noon on Thursday, 2 March if at all possible, please.

I am also copying this letter and the report to the Prime Minister and the Head of the Governmental Statistical Service.

Yours Norman

NORMAN FOWLER

DEPARTMENT OF EMPLOYMENT

RETAIL PRICES INDEX ADVISORY COMMITTEE

TREATMENT OF THE COMMUNITY CHARGE IN THE RETAIL PRICES INDEX

Presented to the Secretary of State for Employment

February 1989

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TREATMENT OF THE COMMUNITY CHARGE IN THE RETAIL PRICES INDEX

CHAPTER 1: INTRODUCTION

Matters to be dealt with

1. We were appointed in October 1988 with the following terms of reference:

> "To advise the Secretary of State for Employment on the effect of the abolition of domestic rates on the construction of the retail prices index and on the way in which expenditure on holidays should be taken into account in the index; and to review progress on implementing longer-term recommendations made in the Advisory Committee's last report (Cmnd 9848, July 1986)".

2. The first item in these terms of reference is a matter of some urgency as rates are being abolished in Scotland in April 1989 (though not until April 1990 in England and Wales) and arrangements need to be made in advance to deal with this situation in constructing the retail prices index (RPI). We have therefore thought it right to address the rates question first, and submit a report dealing with this one issue. We will then turn to the other matters in our terms of reference in the expectation of completing a second report during 1989 in good time for the recommendations, if accepted, to be implemented at the beginning of 1990.

General considerations

3. In the Committee's last report the general approach laid particular stress on two considerations which have also been prominent in our latest discussions. The first of these concerned the need for continuity and consistency in the construction of the RPI. For the index to fulfil its purpose it is essential that the concepts underlying it should not be changed without good reason and that any such changes should be fully explained and justified. In examining the question of the abolition of domestic rates we have found that consistency can be interpreted in a number of different ways, and we do not all attach the same importance to its various aspects; but we do agree that simply following past precedent is less important than the maintenance of a coherent underlying approach. From our different points of view we have sought to ensure that the RPI continues to measure changes in prices across the whole range of goods and services purchased for consumption by households covered by the index. The essential character of the index should therefore remain the same though the precise nature of its coverage will have changed in response to changing circumstances.

4. The second continuing theme in our discussions on this occasion, as on previous ones, has been the need to sustain public confidence in the RPI as a reliable measure. That is not to say that the public's reactions are necessarily a sound basis for determining index methodology, as they may not pass the test of consistency, but in deciding to reject some alternatives for which a case can be made on conceptual grounds we have taken into account (along with many other considerations) the likelihood that they would undermine confidence in the index.

5. As in the past, we have reached our conclusions by consensus: not by counting votes. We have no wish to conceal the fact that we are not unanimous in our view of the central issues, and a body of opinion within the Committee argued in favour of a different outcome from that which we recommend. However, the contentious matters are not all clear-cut, there being many overlapping ranges of opinion rather than two or three distinct alternatives. We believe we have reached an overall position which, while not completely satisfying all strands of thought, takes some account of each of the points of view which have been expressed.

Structure of the report

6. The structure of our report is as follows. In Chapter 2 we describe, by way of background, the nature of the RPI, the present situation as regards the inclusion of rates and the changes which are shortly to take place in the system of local government finance, involving the introduction of a new form of payment, the Community Charge. In Chapters 3 and 4 we go on to consider whether or not the Community Charge should be included in the RPI once domestic rates are abolished, rehearsing at some length the arguments on both sides and coming to a definite recommendation in favour of inclusion. We then address in Chapter 5 the question of how this recommendation could be put into effect: this involves defining an appropriate price indicator, taking a view on whether any allowance should be made for changes in the volume of local authority services and determining how to treat various grants, subsidies and discounts which will reduce the cost falling directly on consumers. Chapter 6 deals with a number of issues arising out of the transition from domestic rates to the Community Charge and the implications of this changeover for the structure of the RPI and the coverage of related indices. We end with a review of our conclusions and a summary of the changes in the RPI which would be apparent to users should our recommendations be accepted and implemented.

CHAPTER 2: CURRENT PRACTICE AND FORTHCOMING CHANGES

Essential features of the RPI

7. The RPI measures the change from month to month in the general level of prices charged to consumers for the goods and services they buy. Despite its name the index's coverage is not confined to items bought in retail outlets: for example it also covers housing costs, gas and electricity charges, motoring expenditure and the prices of a wide range of other services. It includes VAT, excise duties and similar taxes which form part of the prices of consumer goods and services, but excludes income tax, national insurance contributions and other taxes which are levied directly on people irrespective of their consumption. Saving and investment expenditure are also excluded.

8. The index is compiled by defining a "basket" of goods and services and calculating each month the percentage change in its cost. The contents of the basket are based on the actual expenditure of households, its scope comprising virtually everything on which money is spent (with small exceptions defined by our predecessors). The process of index calculation involves determining both the percentage change in representative prices for each category of expenditure (the "price indicators") and the relative importance (or "weighting") to be attached to each in deriving the overall index. The composition of the basket can be changed, normally at the beginning of a calendar year, in order to keep abreast of alterations in patterns of consumption. It is important to recognise that adding a new item or otherwise changing the contents of the basket does not in itself raise or lower the rate of inflation as the index measures the proportionate change in prices: not their absolute level. The eventual effect of the inclusion or exclusion of particular items cannot be predicted as it depends upon whether the prices of those items increase faster or less fast than prices in general.

9. The concept underlying such a price index is that an amount of expenditure is the product of two elements - a price and a quantity. For example, an expenditure of £1 might be made up of two units of a good priced at 50 pence per unit. Equally any *change* in expenditure on that good can be decomposed into a price change element and a quantity change element, and the intention in constructing a price index is to separate these out so as to show the extent to which expenditure has changed on account of prices alone. The index should not be affected by expenditure increases/decreases brought about by increases/decreases in the quantity or quality (technically the "volume") of the goods and services acquired.

10. In principle this decomposition can be applied to any item of expenditure but in practice it becomes difficult, particularly when the units of consumption are not well defined. Some such cases are mentioned later in this report, including standing charges for gas and electricity, licence fees for motor vehicles and television receivers and membership subscriptions of clubs and associations. In each case it is clear that households are making payments and receiving services in return but when the expenditure changes it is not always apparent how much of this is a price effect and how much due to a difference in volume.

Treatment of rates in the RPI

11. Domestic rates have been included in the RPI since its inception. Initially this was because they were generally paid by households as part of the

rent and were inseparable from it, but when owner-occupiers' housing costs were first incorporated in the index in 1956 it was decided to establish rates, together with water charges, as a separate section within the "Housing" group, though the index for this section was not published until 1962. Since the beginning of 1987, following recommendations in our last report, rates and water charges have been treated as separate sections with indices published for each. In January 1988 domestic rates accounted for 43 parts per thousand of the expenditure included in the RPI. (This is shown in relation to the weight for other items in Annex A of this report.) Non-domestic rates are not directly covered by the index, though of course they are reflected to the extent that they influence the prices of goods and services purchased by households.

12. The amount of rates payable by a household depends upon two factors: the "rateable value" of the property occupied (which is supposed to reflect the value of the "shelter" consumed) and the "rate poundage", expressed as an annual levy per £ of rateable value (which varies from one local authority to another according to the services provided and other factors). It is the rate poundage which provides the price indicator for the RPI: any increase in the average rateable value is regarded as a volume effect (which influences the "weight" for rates in the following year). This means in practice that the index increases slightly less than it would if based on the average rate payment; the procedure might be seen as indicating that rates are regarded as a tax on housing rather than a charge for services, unless the rateable value is seen as a proxy for the volume of local authority services consumed by a household. (Such a proxy would only be satisfactory if the aggregate rateable value actually moved in line with the volume of services over time.)

13. The justification for including domestic rates in the RPI has never been fully discussed by the Advisory Committee. In our 1986 report (paragraph 41) we put forward the suggestion that rates could be seen as a tax on the occupation of property and were therefore appropriate for inclusion as a housing cost (just as indirect taxes on the consumption of alcohol, tobacco etc are included in the indices for those items). However, as the purpose of rates is to finance the provision of local authority services their present inclusion in the RPI is not inconsistent with the view that they are a payment for these services, each household's contribution varying according to the size of the property it occupies and the aggregate payment being implicitly related to the amount of services assumed to be provided. Whichever of these standpoints is adopted it can only be a rationalisation of past practice: the fundamental question of whether or not local authority services should be within the scope of the RPI remains to be settled in this report.

Introduction of the Community Charge

14. Domestic rates are to be replaced by a new charge - the Community Charge - which will be payable by virtually all adults at a flat rate, though some eleven million people will receive assistance with payments, around a million students will pay only 20 per cent of the full Charge and certain groups will be completely exempted, including the severely mentally handicapped, those working for charities on low pay and homeless people who are "sleeping rough". The switch from rates is to take place in April 1989 for Scotland and a year later for England and Wales. (The rating system is to remain in place in Northern Ireland and non-domestic rates will continue to be levied in modified form throughout the United Kingdom.) As with rates, the level of the Community Charge will be set by the local authority, and the proceeds will contribute to the financing of locally-provided services. Rates vary between households according to the value of the housing shelter consumed (as represented by the rateable value) whereas the Charge will not vary according to the amount of

local services consumed, except to the extent that the number of adults in a household liable to pay can be taken as a proxy for that household's use of services.

15. The Community Charge, like domestic rates, will finance about a quarter of the cost of local authority services, the remainder coming mainly from non-domestic rates and government grants. The present system is that in most areas the local authority's block grant from central government is larger if it spends less than the centrally-assessed cost of meeting its needs and smaller if it spends more. In future each authority's grant will be fixed with reference to its needs and will not vary with expenditure. Under either system a given proportionate increase in the cost of providing services, above the level assumed in distributing grant, requires a much greater proportionate increase in the payments made by households - a feature which distinguishes these payments from most other charges for services.

Alternative views of the Charge

16. In this report, as in the discussions which led up to it, we have not concerned ourselves with the merits or demerits of the Community Charge as a means of financing local authority services. The relevant legislation having been passed by Parliament, the Charge is to be introduced shortly and our only role is to see that it is treated in an appropriate way in the RPI, but in discharging this remit we have had to look closely at the nature of this new type of payment.

17. The Government's naming of the new payment as a charge suggests in itself that it is being levied in respect of services rendered and, as the proceeds will be used exclusively for the provision of local services, there is clearly considerable justification for this view. On the other hand the Community Charge is widely referred to as a "poll tax" and it does have much in common with direct taxation of individuals. A middle way is to say that the Charge is something of a hybrid - a locally-oriented residence charge combining certain features both of a payment for services and of a direct tax.

18. These different ways of regarding the Community Charge underlie, even if they do not wholly determine, the alternative views as to whether or not it would be appropriate to include it in the RPI. In Chapters 3 and 4 we address this central question.

CHAPTER 3: THE CASE FOR EXCLUDING THE COMMUNITY CHARGE FROM THE RPI

Introduction

19. This and the following chapter consider whether the Community Charge should be included in the RPI or excluded from it, giving the arguments on both sides. We begin with the case for exclusion, which we all thought merited serious consideration and which a number of members positively supported.

Arguments for exclusion

20. The main argument for excluding the Community Charge from the price index is that it is not a price - at least not in the sense in which this term has previously been applied in compiling the RPI. In other words it cannot be related to the purchase of specific units of service provided (in the way described in paragraph 9 above).

21. Those who hold this view identify a number of features of the Community Charge which make it quite distinct from the prices already included in the RPI, notably:

a) The element of individual consumer choice is missing. With other items in the index it is possible to avoid paying the price by not consuming the good or service in question but in the case of the Community Charge the payment is imposed by law. It is true that the local community as a whole can choose (through the electoral process) to enjoy a higher or lower consumption of services in return for a higher or lower Community Charge, but that process is very remote from the individual consumer.

b) Besides being compulsory the Community Charge payable by each adult member of a household bears no direct relation to the volume of services actually consumed. Even for the *average* case the Charge cannot be regarded as the price for a given quantity of services since the quantity may well change over time, and the system for determining central government grants is such that the level of the Charge may not change directly in proportion to the cost of providing services above the level assumed in distributing grant.

c) It is generally accepted that income tax and national insurance contributions should be excluded from a consumer price index such as the RPI, and the Community Charge has much in common with them, being a direct levy on people for the purpose of financing public services. Moreover, income tax helps to pay, through central government grants, for the same services as will be financed by the Charge, so including the latter in the RPI while excluding the former might seem inconsistent.

22. For these reasons some Committee members thought that the Community Charge could not properly be regarded as a payment for goods and services but should be treated as the equivalent of a tax, albeit a tax which is hypothecated for the provision of local services and whose level is locally determined. These members pointed out that the "basket" of items covered by the RPI has never previously included public goods and public services which are provided on a collective basis. Including them now would, they suggested, change the essential character of the RPI and make it difficult to maintain a clear and unambiguous concept of "price" for use in future.

23. Those preferring to exclude the Community Charge from the RPI drew our attention to a passage in the Committee's 1986 report (paragraph 6) which attempted to define the nature of the RPI as follows:

> "We wish to reaffirm the view taken by our predecessors that the RPI is an index of *price* changes and not a "cost of living" index. It is not designed to measure the effect of changes in the kinds, amounts and quality of the goods and services people buy, or in the total amount which *needs* to be spent in order to live. Nor does it measure changes in the cost of maintaining a particular level of consumer satisfaction. The RPI measures the overall change in prices by reference to the cost of a fixed "basket" of goods and services ..."

It was argued that the inclusion of the Community Charge would be appropriate in a cost of living index, since it will clearly represent a significant part of households' outgoings, but has no place in a pure price index such as the RPI.

Possible objections to exclusion

24. Three possible objections to excluding the Community Charge from the RPI are that it would mean that official statistics took no account of this new form of payment by consumers, that it would be inconsistent with the long-standing inclusion of domestic rates in the RPI, and that it would lead to a spurious fall in the level of the index. These objections were responded to as follows.

25. Within the body of official statistics an index already exists which offers a means of reflecting changes in the Community Charge. Since 1979 the Central Statistical Office has compiled as a derivative of the RPI the "tax and price index" (TPI) which covers movements in income tax and national insurance contributions as well as prices. There is no doubt that the Community Charge should and will figure in the TPI, whether as a consequence of being in the RPI or as a separate element. This might attract greater attention to the TPI and we think this index should be subject to more outside scrutiny than it has received in the past, possibly through an extension of the Advisory Committee's role.

26. Those arguing against including the Community Charge in the RPI were not dissuaded by the fact that rates currently appear in it, as they were able to point to a number of differences between rates and the Charge. In the first place it is possible to reduce one's liability for rates by choosing a lower-valued property whereas in future households will have to meet the same costs wherever they live within any one local authority area. (There may also be some limited scope for deliberately joining one of the groups which are exempt from the Community Charge.) A further argument was that rates are an *indirect* tax (in that they are levied on the consumption of housing) and therefore form an acceptable part of a consumer price index, whereas the Community Charge is more like a direct tax (not associated with consumption but levied on individuals) and direct taxes are, as noted above, not generally included in price indices.

27. Though, as explained in paragraph 8 above, the removal of an item from the RPI does not generally lead to a fall in the level of the index, a possible precedent from the past might suggest that this should happen in the particular case of the abolition of rates. The point was made in discussion that in 1979 the Government increased VAT and reduced income tax, the result being a sharp rise in the level of the RPI. The rationale for this was that a direct tax (excluded from the index) had been replaced by an indirect tax (included in the index). It could be argued that the changeover from rates to the Community Charge is simply the opposite of this (a direct tax replacing an indirect one) and that the index should be allowed to fall on this account. However, the

and that the index should be allowed to fall on this account. However, the parallel is not exact since VAT forms part of a transaction price which consumers actually pay, whereas rates are levied on a notional consumption (represented by the rateable value) to which no other price is attached. Even those of us who were inclined to favour excluding the Community Charge from the RPI envisaged that this would be done in such a way as to have a neutral effect on the index as a whole.

28. We are therefore satisfied that it is feasible to exclude the Community Charge from the RPI in a way which would not leave a gap in official statistics or give rise to a step change in the index series and which could be seen as consistent with past practice. However, that is not to say that the arguments for exclusion are sufficiently strong to offset those in favour of including the Community Charge in the RPI, and it is to these that we now turn.

CHAPTER 4: THE CASE FOR INCLUDING THE COMMUNITY CHARGE IN THE RPI

Alternative rationalisations

29. The positive arguments in favour of including the Community Charge in the RPI rest on two pillars, corresponding to the different views of the nature of the Charge which we set out in Chapter 2. In the first place the Community Charge is an inescapable cost directly associated with residence and the occupation of property in a particular area. The link with property is strengthened by the fact that those occupying two houses will pay two Charges while homeless people will pay none. The Community Charge could therefore be said to have some characteristics of an indirect tax, just as rates have, and could be included in the index in a way which is as closely aligned as possible with the current treatment of rates. From this point of view the use made of the revenue is immaterial: it is the nature of the payment itself which dictates that it should be covered by the RPI.

30. The second school of thought reaches the same conclusion by a different route. According to this the link between the payment made to a local authority and the services received from it is relevant and important. The sole purpose of the Community Charge will be to finance local services, the aggregate payments made will be closely related to the amount of services provided, and individual consumers will see the Charge as the price they pay for this provision. Excluding the Charge would therefore cause widespread misgivings that the index was failing to reflect a significant element in the costs which consumers have to meet.

31. There are a number of more specific reasons for wanting to include the Charge. One is that the services provided by a local authority are of immediate relevance and direct benefit to the residents in its area and form a proper part of the "basket" of goods and services which is covered by the price index. It follows that the charges for these services should be part of the index whatever form it were to take, be it a tariff of item-of-service fees or a single omnibus payment such as the Community Charge.

32. This can be seen as justification for the present inclusion of rates in the RPI, and the case for including the Community Charge is perhaps stronger, because its stated purpose is to forge a closer link between the aggregate payments made and the services provided within any one local authority area. More consumers will be liable for the Charge than are liable for rates and those in areas where a high level of services is provided will pay more than those in areas with less provision. This makes the "deal" between consumers and their local authorities more like a conventional market transaction.

33. Whether or not the Community Charge is viewed as a price in some sense our general feeling is that it is no less so than domestic rates. We do not wish to argue that the present inclusion of rates necessarily means that the Community Charge should be in the RPI, but it clearly makes it more difficult to justify exclusion. From the consumers' point of view little will have changed once the Charge has been introduced - payments of similar size (on average) will be made to the same authorities supplying the same services as before - and it would be difficult to convince the public at large that the nature of the new charge was sufficiently different from that of the old to warrant what many would see as a break with past practice.

Analogies with other items in the RPI

34. It must be acknowledged that if rates and the Community Charge are regarded as payments for services then it is a "package" of heterogeneous services which is being bought, and moreover a package over which the individual consumer has no direct control; but the same could be said of several items which are included in the RPI and whose appropriateness for inclusion has never been questioned.

35. For example television and motor vehicle licences are flat-rate charges levied on the consumers of television programmes and public roads and help finance their provision. These have always been included in the RPI though they are not expressed as prices per unit of service and there has been no adjustment for any changes in the quantity or quality of the services in question (though that is not to say that it would have been wrong to make such adjustments in these cases). Alternatively such payments might be seen as purchasing the *right of access* to whatever services are currently being provided. It could be argued that the Community Charge is a similar case, differing only in that individual consumers can choose not to watch television or run a car whereas they cannot avoid benefiting from, and paying for, the public services provided in the area where they live.

36. A further analogy is with subscriptions or membership fees paid to trade unions, motoring associations, clubs and societies, where again the RPI practice has been to make no adjustments for changes over time in the benefits received by members. Perhaps it would have been right to attempt such adjustment but, on the other hand, the benefits could be seen as a unitary package which cannot be decomposed or analysed but which, taken as a whole, represents the collective view of what ought to be provided. In a sense it is the membership itself which is purchased: not the services ultimately financed. It might be thought that the Community Charge paid to the local authority is not intrinsically different from the subscription paid to a local amenity body, apart from the point already made that the Charge will be universal.

37. Finally, even some of the items of consumption whose cost does vary according to individual consumption (such as gas and electricity supply and telephone service) are paid for partly through standing charges which fall equally on all those with access to the facility in question. Water supply and sewerage charges are currently levied on the same basis as rates and in some cases will in future be levied on the same basis as the Community Charge or as a flat rate per household. It would be difficult to justify excluding such payments as these from the RPI, and the Charge evidently has much in common with them.

38. We do not claim that these parallels are exact - it is possible to identify aspects of the Community Charge which make it somewhat different from any of the other items cited here - but we do think they show that the Charge is not a unique case whose treatment needs to be quite distinct from that of those licences, subscriptions and flat-rate charges which are already in the RPI. The Advisory Committee in the past has always preferred to define the scope of the index as widely as possible and including the Community Charge may be seen as consistent with maintaining this stance. Of course a line has to be drawn somewhere and, wherever it is set, the cases which lie just to one side of the boundary will not look very different from those which lie just on the other side. If the Community Charge were to be included in the RPI then there might be a case for saying that (for example) national insurance contributions should likewise be included. On the whole, however, we think there are sufficient grounds for including the Community Charge but going no further. For example,

national insurance contributions are at least in part a form of saving. More generally the local character of the Community Charge and the nature of the services financed (being of direct and immediate benefit to the consumers paying it) make it more appropriate for inclusion in the RPI than any of the items which are currently excluded.

Conclusion

39. Our general conclusion is therefore that the Community Charge should be incorporated in the RPI in some form. Members opposing this, on the grounds set out in the previous chapter, did not abandon their opinion but they recognised that a strong case could be made on the other side and that this case might well carry more weight with users of the RPI and with public opinion in general. The conclusion having been reached, the Committee as a whole proceeded to discuss how best to implement this decision. It is to that stage in the process that we turn next.

CHAPTER 5: METHODOLOGY FOR INCLUDING THE COMMUNITY CHARGE IN THE RPI

Introduction

40. At the end of the preceding chapter we reached the conclusion that the Community Charge should be included in the RPI, but that is not the end of the matter as there are a number of ways in which this result could be achieved. In the present chapter we consider various methodological aspects of the question and put forward some more specific recommendations.

Weighting

41. In constructing a price index it is necessary to consider not only the "price indicator" which measures the rate of change for each item but also the "weight" which determines the relative importance of the item in relation to all the others in the index. In the present case the weighting is straightforward. In conformity with the methodology defined by our predecessors the weight for the Community Charge should be based on the average payment to local authorities by households covered by the RPI. The appropriate payment is that relating to the latest 12-month period for which information is available, and the weight is obtained by adjusting for price changes between that period and the beginning of the year for which the weights are to be used. The necessary expenditure data will be obtainable from the Family Expenditure Survey and the price adjustment can be carried out using the price indicator we recommend in this report. In addition to the Personal Community Charge for which most adults will be liable, local authorities will also be able to levy a Collective Community Charge on the landlords of property where the occupants stay only for short periods and a Standard Community Charge on people with second homes whose main residence is in another area. All three types will be included in the weight, and in principle they should be separately distinguished within it so that an appropriate price indicator can be attached to each.

Price indicator

42. In principle the composition of the average household which underlies the weight should be held constant throughout each year for purposes of calculating the price indicator. In other words the index reflects the expenditure of a household with a fixed liability for the different types of Community Charge. In fact the Standard Charge is to be a multiple of the Personal Charge (at the discretion of the charging authority) and the Collective Community Charge is to be calculated by multiplying the daily contribution rate related to the Personal Charge by the number of person-days. For purposes of measuring the overall proportionate change in price the Personal Community Charge can therefore stand as an indicator for all three, though if the average multiplier for calculating the Standard Charge were to change from year to year then an adjustment should be made for this.

43. As we explained in Chapter 2, the price indicator for rates in the RPI has been an index of the average domestic rate poundage: it has not increased on account of the slow progressive rise in the average rateable value between revaluations. Similarly, if our recommendations are accepted the Community Charge price indicator will not change in response to any alteration in the number of adults per household. As a point of information an index of "payments per adult" would have risen about 4 percentage points more over the last five years than the existing index of "payments per £ of rateable value" (by 56 per cent as against 52 per cent). This is on account of the greater buoyancy in aggregate rateable value than in the size of the adult population.

Volume adjustment

44. As we pointed out in Chapter 2, central to the concept of a price index is the decomposition of an expenditure change into two parts: a price element and a quantity element (of which only the former affects the index) and taking the Community Charge itself as the price could be seen as tantamount to assuming no change in the "quantum" being consumed. Whether this is appropriate depends, once again, upon the way the Charge is perceived. If it is seen as a tax on residence in an area then the Community Charge per adult is indeed the correct price indicator to take. On the other hand if the Charge is seen as a payment for services then the relevant quantum is the volume of services provided (this being understood to involve the quality of services as well as their amount). From this standpoint the Charge per adult is only the correct price to take if the volume of services per adult resident does not change.

45. The point can be made in more practical terms as follows. It is conceivable that local authorities might reduce their Community Charges very significantly by simply cutting services or reducing their standards, and if this were to happen then some of us think it would be quite unacceptable for the RPI to fall as a result. Equally it would be wrong for the index to show an increase just because some communities had decided to provide for themselves (and were prepared to pay for) a higher level of provision than they had previously enjoyed.

46. It may be that, even if in principle it is desirable to take volume changes into account, there is no real need to do so. It has been suggested to us that in practice local authorities do not have scope to expand or contract their main services to any great extent, and illustrative figures produced for us by the Department of the Environment showed that the volume changes which have taken place over the last five years have been small in relation to the errors which would have been associated with their measurement.

47. Our general view is that, for the future, even the direction of change cannot be foreseen with confidence. On average the volume increase in the five years to April 1988 was of the order of 1 per cent per annum but it cannot be assumed that this will continue and that ignoring it will impart an inflationary bias to the index. On the one hand it seems reasonable to expect that local services will share in the general growth of national output but on the other hand the Community Charge has been seen as a way of restraining their provision. All in all we prefer to say that the future change cannot be predicted but is unlikely to be on such a scale as to distort the index for the foreseeable future.

48. However, those members disposed in principle to take volume changes into account were reluctant to rely on a mere assumption that their effect would be negligible. We therefore examined ways in which adjustments might be made. Ideally one would want to calculate the change over time in the volume of services so that this could be discounted in working out the price change. For example if the Community Charge were to increase by 8 per cent but the volume of services were cut by 10 per cent then the true price change for local authority services would be a rise of 20 per cent (as 1.08 divided by 0.90 equals 1.20).

49. Some of us think a volume adjustment of this sort would be appropriate in an index of the price of local authority services, both from an intuitive point of view and as being in keeping with the fundamental index number principle of measuring the cost of purchasing a fixed quantity of goods or services. One could envisage making such an adjustment every month as the level of provision might be changing continuously, but, quite apart from the severe practical

difficulty of developing a satisfactory method of doing this, we are convinced that in the short term local authorities cannot make significant changes in the services they provide. Moreover we do not think users of the RPI would expect the component representing local authority services to go up or down at times of year when actual payments were not changing. In our view the most one could expect, were volume adjustment considered appropriate, is that in the months when Community Charges were altered (normally April of each year) the compilers of the index should make the best possible estimate of any change in the total volume of services which was associated with the alteration in payments. The adjusted index would then remain at the same level until the next alteration in the Community Charge, normally a year later.

50. It is one thing to specify the sort of volume adjustment which could in principle be applied and quite another to be satisfied that such an adjustment could actually be carried out using the data which are likely to be available. We have therefore examined with some care the methods which might be used, with the assistance of some helpful information and guidance which was provided by the Department of the Environment's representatives on the Committee and is summarised in Annex C to this report.

51. One way of measuring changes in the volume of local authority services would be to use manpower numbers as a proxy for the quantity of inputs, but we concluded that it would be difficult to take adequate account of changes in the quality of the services (for example through employing more highly qualified staff), the efficiency with which they were provided or the substitution of capital equipment for labour. There would also be serious problems in keeping track of numbers employed in providing services which had been contracted out by local authorities, and delays in providing information even on authorities' own staff.

52. Another way of measuring changes in the volume of local authority services is on the basis of the information prepared by local authority finance officers in planning their budgets. These budgets allow a projected change in the volume of services to be calculated, together with an estimate of the likely inflation in unit costs. Using existing data sources comparisons of actual expenditure could only be made two years in arrears, which we think would be unacceptable. The alternatives are to compare the budgeted expenditure for the forthcoming year either with the corresponding budget figure for the previous year or with the estimated out-turn for that year. Either of these might give rise to calls for the index itself to be "corrected" in due course. We reaffirm the view the Advisory Committee has always taken in the past that, while each month's index should be based on the most accurate and up-to-date information available at the time of its compilation, there should be no question of revising the figures once they have been published.

53. It therefore appears that there is no method currently available which would enable changes in the volume of local authority services to be estimated in a way which would command general confidence and approval. We are not convinced that it would be impossible to develop such a method, and in particular we think more use could be made of the wealth of raw data already available from local authorities and their organisations on the *outputs* of local authority services; for example the number of pupils educated in schools or the mileage of roads maintained. Such statistics would be intrinsically more appropriate for our purpose than the input measures discussed above, though they are less amenable to aggregation and analysis. Their main drawback is that they might not fully reflect changes in the quality of services provided but, given the tight control of standards exercised by central government, this might not be a serious problem. If significant changes were taking place in the provision

of local services then some of us would prefer an imperfect adjustment to none at all.

54. We cannot rule out the possibility of such adjustments becoming necessary in the future. If for example there were significant moves towards privatisation of what are currently local authority services, so that their cost were met directly by consumers rather than indirectly via the Community Charge, then in line with our concern for continuity we would want steps to be taken to prevent a spurious fall in the level of the RPI. This could be done by ensuring that the increase in the use of private facilities was reflected in the index as a price increase alongside the concomitant reduction in the cost of local authority services. We would also be concerned if there were a progressive diminution in the scale or standard of the services being provided by local authorities. We therefore think that the question of volume adjustment should be kept under review by the Department of Employment and the Department of the Environment, including the problem of allowing for quality changes, and that the Advisory Committee should be invited to look at the matter again in a few years' time. If necessary, we can then consider whether the situation has changed sufficiently for us to reconsider our present conclusion about allowing for volume changes. Keeping the situation under surveillance in this way would be consistent both with the status of the Community Charge as an innovative measure whose effect cannot be predicted, and with the Committee's continuing role as a reviewing body.

55. To sum up, the need for volume adjustments is in doubt for two reasons: if the Community Charge is seen as a residence tax then they would be inappropriate, while if the Charge is seen as a payment for services which in practice do not change significantly in quantity or quality then adjustments would be redundant. Even those members who believe that volume adjustments would be appropriate and might become necessary nevertheless accept that for the present it is not feasible to make them. Our conclusion is that the appropriate response to the introduction of the Community Charge is to treat it in a similar way to that in which rates are currently treated, without adjustment for changes in the volume of local authority services.

Treatment of grants, subsidies and discounts

56. We turn now to the treatment of government grants, subsidies and discounts which in one way or another reduce the extent to which the cost of local authority services falls directly on the residents of the area concerned.

57. In the first place we have considered how to treat that part of net local authority expenditure (roughly three-quarters of the total) which will not be financed from the Community Charge. Two sources of revenue are involved - non-domestic rates and government grant - and these are deducted from gross costs for the purpose of setting the Community Charge. They appear to us to be in the nature of general subsidies akin to (for example) grants towards the provision of uneconomic but socially-necessary railway services. In our 1986 report we decided that such transfers, which benefit all users of the service irrespective of their individual circumstances, should be regarded as reducing the price for the service. In conformity with this principle we think that the "price" for local services should not reflect the whole cost of supplying them but just that part of the cost which falls on local residents in the form of the Community Charge. It follows that, other things being equal, the RPI would increase if other sources of revenue were cut back (thereby causing the Community Charge to rise) and decrease if they were made more generous (allowing the Charge to be reduced).

58. Secondly we recognise that many residents with relatively low incomes will receive assistance, through rebates, in paying their Community Charge, just as they currently qualify for help with rates (though everyone will be expected to pay at least 20 per cent of the full amount). Again following current practice, as laid down in our 1986 report, we regard this assistance as a subvention on income rather than a price reduction. The supplier of services (that is the local authority) will receive the full amount of the Charge and we think it is this full amount which should be regarded as the price charged, even though part of it is being paid not by the consumer but by the social security system. This form of assistance differs from that referred to in the previous paragraph in being selective. Where a subsidy or grant is made available by a third party (not the supplier or the consumer) we would wish to see it treated as a price reduction if it benefited all consumers but not if it benefited only a selected group.

59. A similar case is that of students, who will only be required to pay 20 per cent of the full Community Charge in the area where they study. The residue will not be made up by a specific payment to the local authority on behalf of each individual but the number of students in an area will be taken into account each year in determining the local authority's grant from central government. Again therefore the supplier of the service will ultimately receive the full amount of the Personal Community Charge, and current practice dictates that it is this which should be regarded as the "price" for RPI purposes, even for students.

Conclusion

60. What we propose therefore is an index whose weight is based on actual liability for Community Charge (of all types) and whose price indicator is the full Personal Charge, ignoring the fact that in the cases of benefit recipients and students the full cost is not all paid by the consumers themselves. For the present the price indicator should not be adjusted for changes in the volume of services provided by local authorities.

CHAPTER 6: DEALING WITH THE TRANSITION FROM RATES TO THE COMMUNITY CHARGE AND ITS IMPLICATIONS

Relating the old and new regimes to one another

61. Having defined the index we should like to see established we now deal briefly with a number of issues related to the transition between the present situation in which rates are included in the RPI and a future one in which the Community Charge would be included. Normally such changes are handled by calculating the price indicator both ways for a single month, one figure ending the old series and the other initiating the new one. The two series can then be linked so that the change in coverage does not create any discontinuity. This method cannot be applied in the present case since there will not be a month in which (for any one part of the United Kingdom) *both* rates and the Community Charge are being paid simultaneously. Moreover, the changeover is taking place at the beginning of a financial year, when in the normal course of events there would be an increase in payments by households to local authorities. It would be wrong to construct the RPI in such a way that this increase was not reflected.

62. In practical terms the price indicator will need to be changed at some point from the average rate poundage (a percentage figure) to the average Personal Community Charge (an amount of money in £ per week). It was suggested to us at one point that there would be advantage in doing this at the beginning of 1989, so as to remove the need to modify the methodology part-way through the year and avoid a situation in which the index for Scotland was being calculated in one way and that for England and Wales in another (the Community Charge having been introduced in the former case but not yet in the latter). We are not persuaded by these arguments. There is no way of avoiding the need to bridge the gap between two different regimes (one applying to the present rating system and the other to the new Community Charge system) but we see no reason to introduce a third regime, applying in the interim between January 1989 and the time when rates are abolished. The proper approach would be to maintain the present procedures without any change whatsoever for as long as the rating system remains in being in each part of the United Kingdom, switching to the new procedures in April 1989 for Scotland and in April 1990 for England and Wales. From April 1989 onwards the index should be called "Rates and Community Charges" (this title being retained after March 1990 because the rating system is to continue in Northern Ireland).

63. The problem in April 1989 and 1990 will be that of finding an appropriate "base price" (for January) with which to compare the Community Charge which has just started to be levied. What we recommend is that this base price should be the amount of domestic rates payable in January averaged over all the adults subsequently becoming liable to pay the Community Charge. From a computational point of view, therefore, the Charge will be treated as a continuation of rates under a different name, and calculated in a slightly different way (as a payment per liable adult rather than a payment per £ of rateable value). The technical details of this methodology are set out in Annex D.

The "index household effect"

64. A feature of the Community Charge which has not yet been mentioned is that it will redistribute liability for payments to local authorities as between different types of household. In particular, those households which consist of only one or two adults and have relatively high rateable values will in future

pay a smaller share of the cost of local authority services, while those with low rateable values and more than two adults will pay a larger share. The distinction between "gainers" and "losers" will be correlated to some extent with that between the households which are covered by the general RPI and those which are not. The latter comprise two categories: households whose total gross income is in the top 4 per cent of the distribution and one- or two-person pensioner households mainly dependent on state benefits. For different reasons these "non-index households" will, relative to other households, pay less in Community Charge than they have been paying in rates; correspondingly the households covered by the index will pay relatively more. (This is separate from the effect that, whether in the index category or not, households with a relatively large number of adults will in future pay a bigger share.) The once-for-all "index household effect" is expected to raise by about 3½ per cent the average payment per adult in index households, and we have considered whether this should feed through into the general RPI as a price increase. If it did so it would add between 0.1 and 0.2 per cent to the "all items" index.

65. Throughout most of the RPI's coverage it is unnecessary to distinguish between the price changes faced by index households and those faced by non-index households, since they can reasonably be assumed to be the same. However, in some cases there has been reason to expect differences (particularly in the area of housing costs) and efforts have been made in the past to obtain price indicators which are specifically relevant to *index* households, as opposed to all households. Most of us see no reason to depart from this convention in the case of the switch from rates to the Community Charge: if index households do indeed find themselves paying more as a result (over and above the normal annual increase in payments) then this should be reflected in the general RPI. There is a contrary view, that "index households" are defined only to prevent the *weighting* of the index from being unduly affected by those with untypical expenditure patterns, and that the *price indicators* should not be restricted to any particular sub-group of the population, but this was supported by only a minority of Committee members.

Index structure

66. The rates component of the RPI has always been included in the "Housing" group, together with rent, mortgage interest payments, water and sewerage charges and the costs of repairs and maintenance. The justification for this is that rates are charged on the value of the housing occupied (as measured by the rateable value) and can be seen as part of the price of occupation. The Community Charge is not so closely linked to housing, but its level does depend upon the administrative area in which one's dwelling is situated, those who are homeless pay no Charge and those with two homes pay twice. The Charge is therefore related to housing to some extent. A further point is that the Community Charge will have much in common with water and sewerage charges which (though the basis on which they are levied will change over the next few years) will continue to be a legitimate part of the "Housing" group.

67. We therefore recommend, in the interests of presentational continuity, that the index for "Rates and Community Charges" should form part of "Housing", though this will extend the meaning somewhat to embrace residence charges as well as the cost of shelter and maintenance. Since a separate index and weight will be published for this section it will be possible to calculate by subtraction indices which exclude rates and the Community Charge either from housing costs or from the "all items" index, should such indices be required.

Pensioner price indices

68. Finally we should mention the special quarterly price indices which are compiled for one- and two-person pensioner households mainly dependent on state benefits, which are not within the coverage of the general RPI. Since their inception these pensioner indices have excluded all housing costs (including rates), principally because they tend to occupy different types of property from index households and the housing costs they face are affected in a more significant way by social security benefits. If the pensioner indices were widely used for uprating and other purposes then we should want to look again at their coverage, and perhaps consider whether ways could be found of including housing costs. However, the amount of attention paid to them is small in relation to that given to the general RPI. For the present therefore we recommend no change in the way the pensioner indices are constructed: we think they should exclude the Community Charge just as they have excluded rates (together with rent, mortgage interest payments and other housing costs).

CHAPTER 7: SUMMARY OF RECOMMENDATIONS

69. As we have already said, we are not unanimous in our view of the matters before us, or the outcome which we should favour, but a consensus has emerged which commands a wide measure of support. We recommend as follows:

i) No change should be made in the method of constructing the present index for domestic rates until their abolition makes this necessary, in April 1989 in Scotland and a year later in England and Wales.

ii) Once domestic rates have been abolished the Community Charge should be included in the RPI. It may be seen as a tax on residence in a particular local authority area or as a payment for services.

iii) The Community Charge index should form part of the "Housing" group within the RPI, as rates have always done.

iv) The price indicator should be the average liability for Personal Community Charge within the households covered by the general RPI. Under the new regime these households will have to meet a larger share of the cost of local authority services than they do under the rating system and this should be reflected in the RPI as a price increase.

v) The weight should be based on the liability of index households for Community Charge of all sorts (Personal, Collective and Standard).

vi) Some Committee members would ideally like changes in the Community Charge to be adjusted for RPI purposes to allow for alterations in the quantity and quality of services provided by local authorities. We do not think it is practicable or necessary to make such adjustments at present but the possibility of their being needed in future ought to be kept under review.

vii) The contributions towards paying for local authority services which are made by central government grants and by non-domestic rates should be treated as reducing the cost included in the RPI. However, income-related rebates and the concession whereby students pay only 20 per cent of the full Community Charge should be regarded as subventions on income rather than reductions in price.

Practical effect of implementing the recommendations

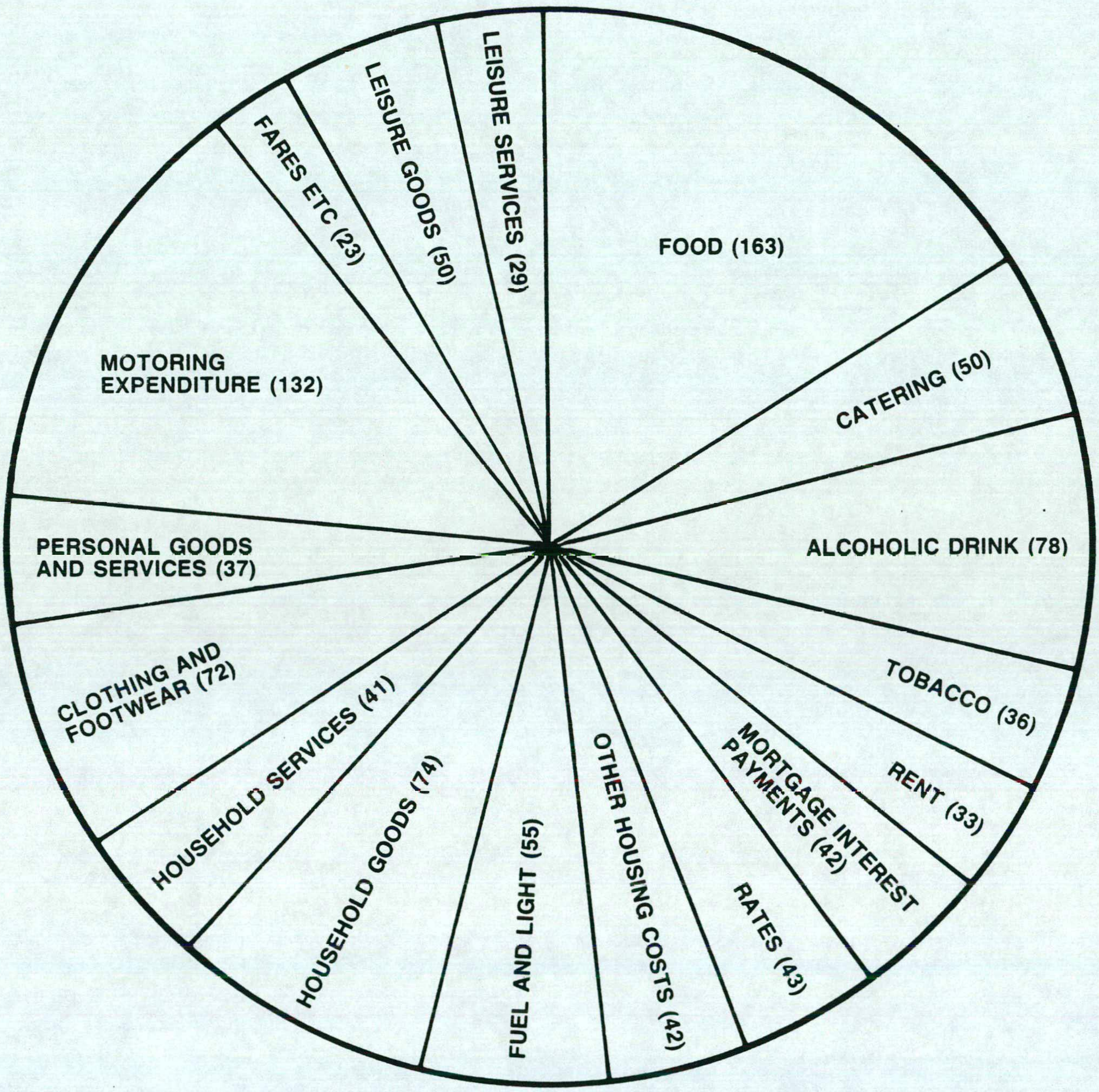
70. If our recommendations are accepted and implemented then the RPI will be left looking very much as it does now. The component index for rates which is published at present would then include the Community Charge and appear in the "Housing" sub-group of the index, slightly broadening the concept of housing costs but in a way which we think most people would accept as reasonable.

71. The way in which we propose that changes in the Community Charge should be measured is simple and straightforward: indeed it is probably the way in which most consumers would at first sight expect the Charge to be reflected. Its introduction would lead to a small increase in the level of the index; thereafter the movements in the Charge would contribute, along with all other price movements, to the change in the RPI from year to year.

72. As we have shown in the body of our report, the introduction of the Community Charge raises issues of principle and concept for the construction of the RPI which are difficult to resolve, but we believe that our recommendations represent a solution which will be widely acceptable. We commend them for consideration.

ANNEX A

WEIGHTING OF DOMESTIC RATES IN THE RPI (1988)

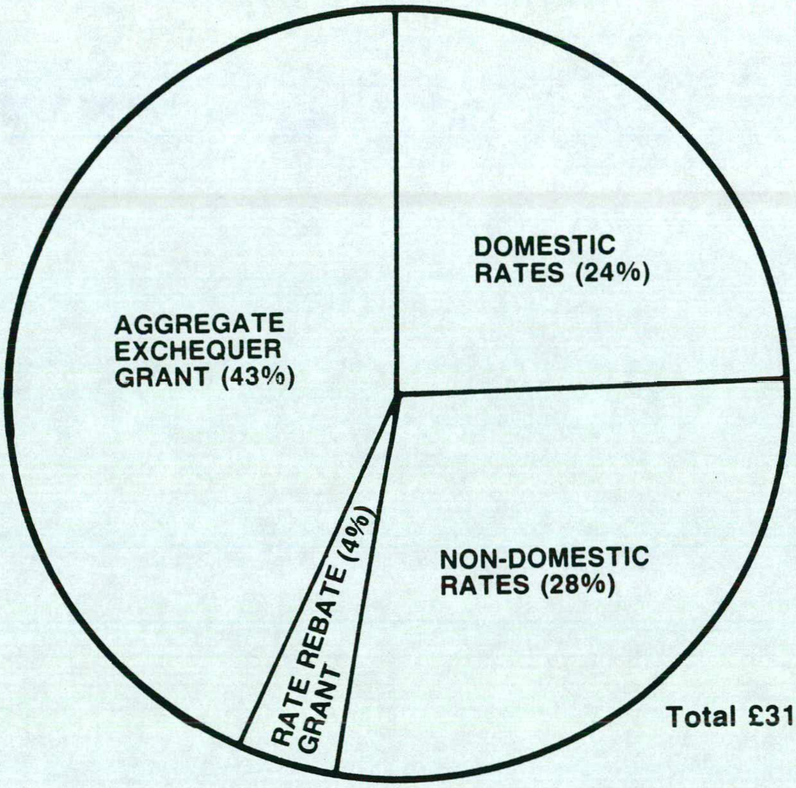


Figures are parts per thousand in the general index

ANNEX B

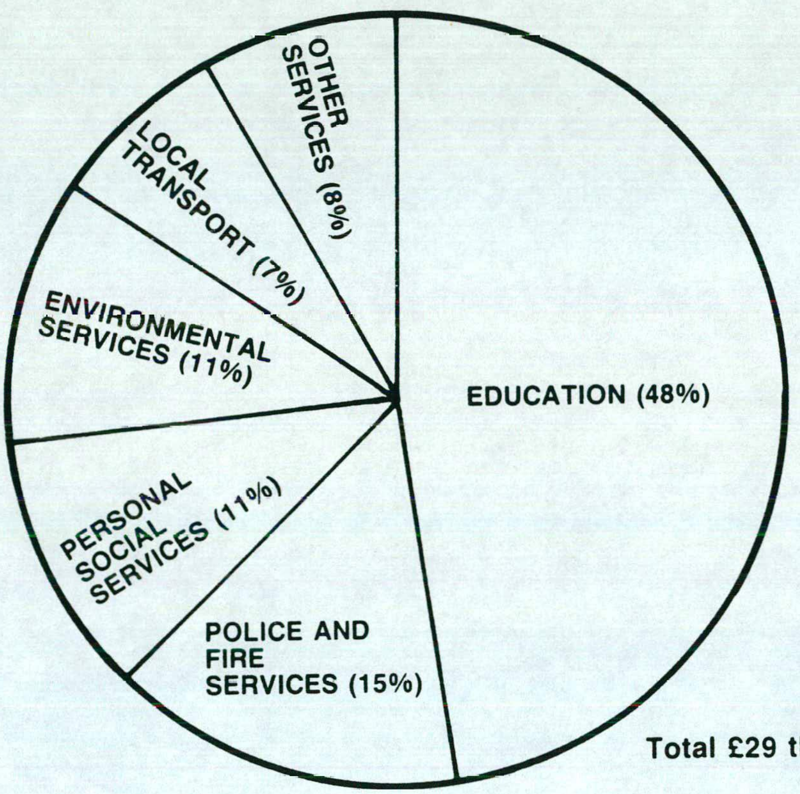
MAKE-UP OF LOCAL AUTHORITY REVENUE AND EXPENDITURE

RATE FUND REVENUE
ACCOUNT NET INCOME 1988-89



Total £31 thousand million

CURRENT EXPENDITURE
BUDGET FIGURES 1988-89



Total £29 thousand million

ANNEX C: MEASURING CHANGES IN THE PROVISION OF LOCAL AUTHORITY SERVICES

Introduction

1. This annex describes the available methods of measuring changes in the provision of local authority services, which are mentioned briefly in paragraphs 51 and 52 of the report. One method is to proxy the quantity of inputs by using local authorities' reported expenditure deflated by a pay and prices index for local authority services, while the other is to use local authority manpower data as a proxy quantity measure. There are technical difficulties inherent in both options, which were regarded as insuperable in the short term. The following paragraphs set out the problems in more detail.

General issues

2. Any method based on resource cost has the disadvantage that no account is taken either of changes in the efficiency with which resources are used or of changes in the quality of the services provided. Such effects may be regarded as intrinsically unquantifiable, though there could be a tendency for efficiency effects and quality effects to be offsetting.

3. The Charge is to be paid by each individual in respect of the whole range of community services but it will not relate to all expenditure by local authorities (as included in the national accounts): only to that met from their "general funds". For example, local authority trading services such as markets or toll bridges are almost entirely funded from sales, fees and specific charges. Another example is council housing which, it is proposed, local authorities will not be able to subsidise from their general funds (and hence from the Community Charge) after 1990.

4. For those services which *are* financed by the Community Charge there is also a distinction between current and capital expenditure, the latter arising mainly from debt charges on past capital projects rather than the actual costs of new capital investment. It would be difficult to separate price and quantity effects for capital financing items: the only realistic measures of quantity for the purpose of the RPI would be those derived from current expenditure on local authority general fund services.

Measuring the quantity of inputs to local authority services

5. Subject to the general points made above, two possible ways of devising proxies for changes in the quantity of inputs are:

a) Estimating planned increases in the volume of inputs by comparing budgets for the year to which the Community Charge relates with estimated out-turns for the previous year (on the same price base);

b) Estimating increases in the volume of inputs between successive years' plans by comparing budgets for the year to which the Community Charge relates with budgets for the previous year (on the same price base);

c) Estimating increases in the volume of inputs between the latest available figures for actual expenditure by comparing final out-turns (on the same price base) two years in arrears.

6. In the cases of (a) and (b) the main problem is that planned (or budgeted) increases in quantity may not be achieved for a variety of reasons, including changes in the demand for services and errors in the inflation forecasts. In principle such errors could be dealt with by revising previously-published RPI indices, by making an adjustment to the level of the RPI when the next figure was published or by specifying that the data to be used for purposes of the RPI should be those contained in the budget returns, whatever the eventual outcome. The first of these options could be absolutely ruled out while the others were thought to be highly unsatisfactory.

7. Option (c) above might also appear superior to (a) and (b) in that it uses actual rather than planned increases in quantity, but deflating changes in the Community Charge in one year by changes in quantity which had taken place two years earlier might produce a perverse result. For example if a retrenchment in services were followed two years later by an increase in services then, under option (c), the price indicator for the Community Charge would be seriously overstated in the later year. The reverse effect would apply if there were an increase in services followed by a retrenchment. Over a run of years such distortions are likely to cancel one another out but for individual years the errors might be uncomfortably large.

Manpower

8. The second possibility considered by the Committee involved the use of manpower as a volume indicator. Manpower data are collected by the Local Authority Conditions of Service Advisory Board on a quarterly basis under the aegis of the Joint Manpower Watch. It would be possible to use the latest annual percentage change in manpower as a proxy quantity change, based on the aggregate number of full-time equivalent employees (excluding special employment and training measures). However, the figures cover all employees of each authority: it is not possible to split them into those working on trading services, council housing and general fund services. In addition, for contracted-out services there is no information on the numbers employed outside local authorities, even though Community Charge payers will meet the cost of these services. It would be difficult to make appropriate adjustments for these deficiencies of coverage. The use of manpower as a proxy quantity indicator would also ignore any changes in running expenses and other costs such as accommodation, transport and supplies. The evidence is that in recent years growth in manpower has been less than that in the quantity of inputs discussed in the previous section.

9. The latest information on manpower available in time for the April RPI is for December of the previous year, though this is subject to some revision. The latest final figures relate to December a year earlier.

10. To sum up, a problem common to both the options described above is that at the time when changes in the Community Charge are being taken into the RPI there will be no information on the precise level of services that will actually be provided to Community Charge payers. Proxy measures would have to be used instead. These proxies are imperfect and on occasion there are likely to be significant differences between them and the actual change in the provision of services.

11. Apart from this general difficulty each of the options raises specific problems. The expenditure method measures inputs rather than the outputs which are what the RPI is concerned with, and it could overstate Community Charge inflation if authorities were making efficiency or quality improvements. All the proxies are effectively *forecasts* of change, there are bound to be differ-

ences (which might be substantial) between forecasts and out-turns, and none of the ways which have been suggested for dealing with these discrepancies is wholly satisfactory. Also, because there is no realistic way of measuring quantity change for capital expenditure, the methods suggested would ignore this part of the Community Charge's coverage.

12. In addition to these difficulties the manpower option has the drawback of being based on only one of the various inputs to local authority services. The level of manpower can change, within a fixed total of inputs, as a result of substitution of bought-in services or goods.

13. It can be seen that each of the attempts to identify a proxy quantity effect for purposes of adjusting the RPI is open to serious practical objections. Against this background it was decided to recommend against the use of such proxies, at least for the foreseeable future.

ANNEX D: WEIGHT AND PRICE INDICATOR FOR THE COMMUNITY CHARGE

Introduction

1. This annex sets out in more detail than is possible in the body of the report the method by which the weight and price indicator for the Community Charge will be calculated if the recommendations of the report are accepted.

2. The RPI is a weighted average of changes in the prices of practically all the items bought by index households for consumption. The weight attaching to any item is the average weekly expenditure on that item relative to the average weekly expenditure on all items, and is expressed in parts per thousand. For purposes of presentation the items are combined into sections (for example bread, beer and furniture) and the sections into groups (such as food, drink and household goods), each section and group having its own weight - the sum of the component item weights - and its own price index - the weighted average of the component item indices. In terms of index construction each item index is itself a weighted average of different price changes: for the various types and brands of that item, the various sorts of outlet in which it can be bought and the various parts of the country in which different prices might be charged.

3. At present local authority rates are a section of the index, with an overall weight of 43 parts per thousand and two component items: one for Great Britain and another for Northern Ireland. The index for Great Britain is a weighted average of changes in rate poundages across England, Scotland and Wales and it is proposed that the index for the Community Charge should be constructed in a similar way. As there will be a period when the Community Charge is in payment in Scotland but not in England and Wales these will be defined as separate items, for which separate indices will be calculated (but not published) and a separate item index will continue to be calculated (but again not published) for rates in Northern Ireland

The weight to be attached to the Community Charge index

4. This should be the average weekly expenditure of index households on the Community Charge (including the Standard and Collective Charges) as a proportion of their average expenditure on all items. It should be based, as for rates and almost everything else in the RPI, on the 12-month period ending in the middle of the previous calendar year, revalued to the price levels ruling in the latest January using the RPI component price index for the section in question.

5. The information required for weighting purposes will be obtainable from the Family Expenditure Survey. It will relate to liability to pay the Community Charge rather than actual payments, and be recorded before any allowance is made for rebates or concessions for which some Charge-payers will be eligible.

Price indicator

6. As stated in the report, changes in the Personal Community Charge per adult can be taken as the price indicator for changes in the Charge as a whole, including the Collective and Standard elements. In principle the indicator should be the average across all local authorities of the change in the Personal Charge per index household. Because the Charge is levied per eligible adult, *actual* payments per household may change slightly over time with changes in household composition. It would not be appropriate, however, for this to be reflected in the index. The appropriate "price" is the Charge per *household of fixed composition*, which is the same as the Charge per eligible adult.

7. Information will be available centrally each April about the average Personal Charge for all local authorities, on which the index for Great Britain can be based. Once information starts to become available from the Family Expenditure Survey it may be possible to take account of variations between areas in the proportion of eligible adults who are in index households. It is expected that the Community Charge will change only in April but, should adjustments take place in any other month, these will be treated in the same way.

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CHIEF SECRETARY

FROM : A J C EDWARDS
24 February 1989

cc Chancellor
Sir P Middleton
Mr Anson
Mr Phillips o/r
Mr Monck
Mr Luce
Mr St Clair
Mr Potter
Mr White
Mrs Chaplin

[illegible]

Ch
This seems a barmy idea to me (DOE's, not what AJCE proposes, which is absolutely right) AA

PROPOSED POLICY EVALUATION OF COMMUNITY CHARGE

At a financial management review meeting with DOE before Christmas, I expressed interest in DOE's proposals for evaluating the community charge. Mr Fletcher of DOE has responded by sending me the attached outline of an evaluation project.

2. What DOE have in mind is a three-stage project, as follows:

i. a review of existing research and literature on awareness and accountability;

ii. a programme of interviews to establish the levels of awareness and accountability under the domestic rating system; and

iii. a programme of interviews in 1990 to establish the level of awareness and accountability under the community charge.

They say that their Ministers have approved this project and that they intend to publish the results.

3. In general, as you know, the Treasury is second to none in its eagerness to ensure that policies, not least new policies, are properly and systematically evaluated. It does seem to us, however, that DOE's plans are technically questionable and have a considerable potential to embarrass the Government.

4. We see no particular problem about items i. and ii. of the proposed prospectus. It will undoubtedly be useful in future times to have some comparator information about the existing rating system.

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5. The devil lies, as it seems to us, in the suggestion that researchers should be invited to establish conclusions in 1990 about awareness and accountability under the community charge, with an advance commitment to publish. The community charge will still be in its infancy in 1990. The total levels of the charge in individual authorities will still be dominated by the transitional safety net arrangements. The air will still be thick with propaganda and counter-propaganda about the reasons for the level of charges. From a technical point of view, therefore, it would seem much too early to reach conclusions on awareness and accountability as soon as 1990 or early 1991. So far as the politics are concerned, moreover, such a report could easily have unflattering things to say at a politically sensitive time about the impact of the flagship policy. Commissioning such a project on this time-scale seems questionable in itself; the commitment to publish the results, even more so.

6. What we are inclined to do, if you agree, is to write to DOE counselling extreme caution. We would have it in mind to suggest that item iii. in the proposed research should be timed for mid-1992 at the earliest, not 1990 or 1991; that the evaluation should be conducted in-house; and that prior commitments to publish should be eschewed. So far as the short term is concerned, we might suggest that DOE would do better to confirm that the Audit Commission will be looking at the efficiency, in an operational sense, with which local authorities are implementing the arrangements for collecting the community charge and NNDR. Mr St Clair has given me in addition a number of valuable technical points on the DOE's suggestions which I would propose to pass on to them.

7. As implied above, the DOE's proposals raise sensitive political issues. We would therefore appreciate your guidance.

AJCE

A J C EDWARDS

ANNEX A

RESEARCH PROJECT - THE COMMUNITY CHARGE

Introduction

1. The Government has legislated to replace domestic rates with the community charge - and to make various other changes to the local government finance system - because it believes that the existing arrangements do not promote accountability; and that the post-1990 system will. The new arrangements will mark a dramatic change in the way local government is funded, and there will be increased cost for local authorities in administering the new system.

2. It is Government policy that all new policies should be evaluated and the plans for evaluation including the costs clearly set out.

Objectives

3. The objective of this evaluation would be to monitor the extent to which the new arrangements increased awareness about local spending and whether as a result this increased accountability. "Awareness" for these purposes might be taken to mean whether adults resident in an area

a. understood the cost of providing local services;

b. saw the relationship between the level of their council's spending and the size of community charge bills; and

c. understood the link between changes in spending and changes in the bills they face.

Accountability would be defined as whether awareness led to changes in

d. whether people normally voted at local elections or would be more likely to do so in future;

e. participation in local politics.

f. other forms of participation eg ratepayers action groups.

Methodology

4. To achieve these objectives a survey would need to establish the awareness and accountability 'scores' for the present system, and then see whether those scores changed in 1990. That means a baseline survey in June/July1989/90; a follow-up in 1990/91; and possibly further surveys thereafter (depending, particularly, on whether any transitional arrangemets might cloud the full accountability of the new system in the early years). Given that media coverage and other information on the new scheme may already be having an impact on attitudes and awareness it will also be desirable to conduct a review of the research literature relating to public perceptions of local government spending prior to the development of the new legislation. This will form a basis for comparison with the new survey information as well as contributing to the framing of appropriate questions.

5. In order to understand the reasons for differences in response, the sample survey would need to be stratified in various ways. Apart from the usual stratification by age, sex and class and tenure, the sample would need to include both ratepayers and non-ratepayers. It should also cover people who use many and few local services, and their length of residence in an area and how long they intended to remain there. Urban and rural areas would need to be selected and stratified according to political complexion, high/low spending, for/against Community charge, good/bad on disseminating information.

6. The information from the respondents would be collected by means of a home interview survey using a structured detailed questionnaire. The appropriate form of questions and issues to be covered would be explored first in group discussions and in-depth interviews. One of the issues to be explored would be the accuracy of responses relating to finacial expenditure. (One of the shortcomings of the MORI survey in this area was that it had no way of checking whether those who claimed they knew how much they paid in rates did in fact know.)

7. There would also be a short postal survey to all local authorities, to elicit the views of members and officials about the effects of the new system.

Costs

8. It is estimated that the extra mural spend will be about £60,000 in 1989/90 and £100,000 in 1990/91. About .4 of a researcher's time will be required to manage the project.

chex.rm/aa1/44 **CONFIDENTIAL**

FROM: A C S ALLAN
DATE: 27 February 1989

PS/CHIEF SECRETARY

cc Sir P Middleton
Mr Anson
Mr Phillips
Mr Monck
Mr A J C Edwards
Mr Luce
Mr St Clair
Mr Potter
Mr White
Mrs Chaplin

PROPOSED POLICY EVALUATION OF COMMUNITY CHARGE

The Chancellor has seen Mr Edwards' minute of 24 February, and commented "Mr Edwards is clearly right".

ACSA

A C S ALLAN

CONFIDENTIAL

FROM: P N SEDGWICK
DATE: 28 FEBRUARY 1989

CHANCELLOR

cc Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Edwards
Miss Peirson
Mr Peretz
Mr Gieve
Mr Hibberd
Mr Mowl
Mr O'Brien

Ms Wheldon Tsy. Sol.

CL
OK?
AA

OK w shortly?

RPIAC REPORT ON THE IMPLICATIONS FOR THE RPI OF THE ABOLITION OF DOMESTIC RATES

Mr Fowler has sent you a letter together with a copy of the RPIAC report.

2. He has asked for comments on the report and his proposals for handling it by this Thursday, March 2. All being well he would like to announce his decision on Friday, March 3 by means of an arranged PQ and to publish the RPIAC report at the same time. In practice this would mean that commentators would get copies of the RPIAC report plus a DE note for editors by c. 2.30 pm on Friday. The draft press notice has not yet been received.

3. As you are aware the RPIAC recommends that the average Community Charge per head should replace average rate poundages in the RPI. The change would take place in April this year for Scotland, and in April 1990 for England and Wales. The report also recommends that the Community Charge element of the RPI should be included in the housing component of the RPI (paragraph 67 of the report): this does not have any implications for the calculation of the total RPI.

4. All RPIAC members agreed the report and its recommendations. The text makes clear, however, that there were major divergences of view.

5. The Bank of England cannot make a formal determination under the relevant clause of the IG prospectus until the government's

decision has been made. The Bank have however seen the RPIAC Report, and have assured us that if its recommendations are accepted they will not reach a view that triggers the early redemption clause.

6. Mr Fowler is not strictly speaking correct to claim that the RPIAC's proposals have never been rejected in the past. (The Committee recommended the calculation of regional price indices. DE never calculated them.) It is true, however, that successive Ministers have always accepted recommendations relating to the coverage and calculation of the main RPI. The Committee's recommendations is in line with the view that you and other Ministers reached before the convening of the Committee, following extensive discussion of the possible implications for IGs if the Community Charge was not included in the RPI. There is therefore no problem agreeing with Mr Fowler's proposal that he should accept the RPIAC's recommendations. It is likely that most shades of political opinion and all interested pressure groups will welcome such a decision. The only criticism is likely to come from economists who believe that there are strong technical arguments for excluding a direct tax such as the Community Charge from the RPI. Some members of the RPIAC - Harold Rose, Bill Robinson, and John Pickering - argued strongly for this. They may even set out their views publicly. It is quite likely that some other economists will advance such arguments.

7. There is one aspect of the RPIAC report that could conceivably lead to more significant problems in the future, namely its assessment of "volume adjustment" of the Community Charge indicator used to calculate the RPI. (Paragraphs 44-53 of the report discuss this: Annex C - written by DOE statisticians - discusses the practical problems in some detail.) In spite of some assertions to the contrary (eg the first sentence of paragraph 55), some parts of the report give the impression (a) that adjustment of the Community Charge indicator in the RPI for the volume of services provided is in principle correct, and (b) that adjustment would be necessary if there were large changes in the volume of LA services. The Chairman agreed to these passages to meet the strong advocacy by David Lee of volume adjustment - if necessary of a rough and ready nature.

8. There are two potential disadvantages of such an impression being given:

first it may undermine the credibility of the RPI if local authorities do curb the services they provide and the Community Charge indicator in the RPI is thought to be growing unjustifiably slowly;

and second any possible change in methodology to cope with this problem would almost certainly involve a change of "coverage", and "basic calculation" for the purpose of the IGs prospectus.

9. There is not much that we can do about this aspect of the RPIAC report. If the issue of volume adjustment does indeed arise in future we will of course have to look at it carefully and consider any RPIAC report - but volume adjustment could be difficult to justify as well as to implement.

10. I attach a short letter for you to send to Mr Fowler.

P.N.S

P N SEDGWICK

Juliet insisted on this bit being included!

CONFIDENTIAL

Please type for signature

DRAFT LETTER FROM CHANCELLOR
TO SECRETARY OF STATE FOR EMPLOYMENT

Thank you for your letter of March 26 together with the final report of the Retail Price Index Advisory Committee.

Though formally unanimous, the report reflects what was obviously a wide range of views among Committee members. Nevertheless I agree that you should accept the recommendation that the Community Charge should replace domestic rates in the RPI, and am content with your proposals for the handling of the announcement of your decision.

Copies of this letter go to recipients of yours.

[N.L]

EMPLOYMENT
DEPARTMENT

Department of Employment
Caxton House
Tothill Street
London SW1H 9NF
Press Office (24 hrs) 01-273 6950
Public enquiries 01-273 6969
Exchange 01-273 3000

PRESS NOTICE

48\89 February 24, 1989

RETAIL PRICES INDEX ADVISORY COMMITTEE'S REPORT

Employment Secretary Norman Fowler today said that he had received a report from the Retail Prices Index Advisory Committee recommending that the Community Charge should be included in the retail prices index.

In answer to a Parliamentary question from Emma Nicholson, MP (Devon West and Torridge), Mr Fowler said:-

> "I have today received a report from the Committee recommending that the Community Charge should be included in the retail prices index when domestic rates are abolished. I will shortly be publishing the report and announcing the Government's decision on the recommendation."

Note to Editors:
Membership of the RPI Advisory Committee comprises academics, nominees of the National Consumer Council, the British Retailers Association, the National Federation of Consumer Groups and representatives of the TUC, CBI, Co-Operative Union, Age Concern, the National Chamber of Trade, the Bank of England and Government Departments closely concerned with the RPI.

The Committee's terms of reference are:

> "To advise the Secretary of State for Employment on the effect of the abolition of domestic rates on the construction of the Retail Prices Index and on the way in which expenditure on holidays should be taken into account in the index; and to review progress on implementing longer-term recommendations made in the Advisory Committee's last report (Cmnd 9848, July 1986)".

60/12

Department of Employment
Caxton House, Tothill Street, London SW1H 9NF

Telephone 01-273 . 5803 . . .
Telex 915564 Fax 01-273 5821

Secretary of State

CH/EXCHEQUER
REC. 27 FEB 1989
ACTION MR SEDGWICK
COPIES TO SIR P MIDDLETON
SIR T BURNS
MR ANSON
MR SCHOLAR
MR PERETZ
MR EDWARDS
MS WHELDON - T/SOL

The Rt Hon Nigel Lawson
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1

February 26

Dear Nigel

RETAIL PRICES INDEX ADVISORY COMMITTEE REPORT

I have now received the Advisory Committee's report on the Community Charge issue, and have announced that I intend to publish it shortly, together with my decision on the recommendations. Printing arrangements have been put in hand which would allow publication as a Command Paper on Friday 3 March, on which day I hope to make a substantive announcement by means of an Arranged PQ, with an accompanying Press Notice from my Department.

I enclose a copy of the report, whose main recommendation is that the Community Charge should be included in the RPI in future in a similar way to that in which rates are included at present. I understand that this conclusion was reached by consensus amongst the non-Government members of the Committee, who represent consumers and employees, retailers, business interest and the academic community. As we had agreed, officials representing Government Departments avoided expressing strong preferences on the issues before the Committee. However, the conclusion reached by the Advisory Committee seems likely to be acceptable in all the circumstances, and likely to command greater public acceptance than the alternative of excluding the Charge from the Index.

Though the Committee is only advisory, its recommendations have never been rejected in the past and my view is that we should accept them on this occasion. The arguments for including the Community Charge in the RPI, and, indeed, the

597/2

Secretary of State
for Employment

contrary case, are set out at some length in the report. It is precisely because the matter is a difficult one, which cannot be easily resolved on technical grounds, that we need the seal of approval which a recommendation from an independent body gives. In the past this has provided a good defence against criticism of the methodology followed in compiling the Index. It is helpful that the arguments both for and against inclusion have been set out so fully in the attached report. Nevertheless, there is a clearly stated consensus in favour of inclusion.

You know of the need for early publication, and since your officials have been involved in the discussions throughout, I now seek your early comments (and those of Nicholas Ridley, John Moore and Malcolm Rifkind, to whom I am copying this), by noon on Thursday, 2 March if at all possible, please.

I am also copying this letter and the report to the Prime Minister and the Head of the Governmental Statistical Service.

Yours Norman

NORMAN FOWLER

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~~ Security

CH/EXCHEQUER
REC. - 1 MAR 1989
ACTION MR SEDGWICK
COPIES TO SIR P MIDDLETON, SIR T BURNS, MR ANSON, MR SCHOLAR, MR PERETZ, MR EDWARDS, MR WHEELDON - T/SOL

/113

CONFIDENTIAL

The Rt Hon Norman Fowler MP
Secretary of State for Employment
Department of Employment
Caxton House
Tothill Street
LONDON
SW1H 9NF

1 March 1989

Dear Norman,

RETAIL PRICES ADVISORY COMMITTEE REPORT

Thank you for sending me a copy of your letter of 26 February to Nigel Lawson.

I agree with you that the recommendations reached by the Advisory Committee for including the Community Charge in the RPI are acceptable and are likley to be seen as such by the public. I therefore agree that we should accept them and announce the decision in the way you propose.

I am copying this to the Prime Minister, Nigel Lawson and the Head of the Government Statistical Service.

John

JOHN MOORE

CONFIDENTIAL

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB
01-276 3000

CH/EXCHEQUER

REC.	-2 MAR 1989
ACTION	MR SEDGWICK
COPIES TO	SIR P MIDDLETON SIR T BURNS MR ANSON MR SCHOLAR MR PERETZ MR EDWARDS MS WHELDON-T/SO

My ref: ✓ 2/3

Your ref:

PMP

The Rt Hon Norman Fowler MP
Secretary of State
Department of Employment
Caxton House
Tothill Street
LONDON
SW1H 9NF

2 March 1989

Dear Norman

RETAIL PRICES INDEX ADVISORY COMMITTEE REPORT

Thank you for copying your letter to Nigel Lawson of 16 February to me. The Advisory Committee's report recommending that the community charge should be included in the RPI in future in a similar way to that in which domestic rates are included at present is very much in line with my own views and I wholeheartedly welcome your proposal to accept it. The report will serve to bolster public confidence in the RPI in a way that avoids giving the opposition ammunition to use against the community charge.

The arrangements you have in hand for publishing the report should serve to demonstrate the importance that the Government attaches to this matter, and I agree that it is helpful that the arguments are so fully set out.

/ I am copying this letter to the Prime Minister, Nigel Lawson, John Moore and Malcolm Rifkind and also to the Head of the Government Statistical Service.

Yours ever
Nicholas

NICHOLAS RIDLEY

CONFIDENTIAL

CHANCELLOR OF THE EXCHEQUER

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

2 March 1989

Rt Hon Norman Fowler MP
Secretary of State for Employment
Department of Employment
Caxton House
Tothill Street
LONDON
SW1H 9NA

cc: PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Edwards
Miss Peirson
Mr Peretz
Mr Gieve
Mr Sedgwick
Mr Hibberd
Mr Mowl
Mr O'Brien

Ms Wheldon TSol

Dear Norman

Thank you for your letter of March 26 together with the final report of the Retail Price Index Advisory Committee.

Though formally unanimous, the report reflects what was obviously a wide range of views among Committee members. Nevertheless I agree that you should accept the recommendation that the Community Charge should replace domestic rates in the RPI, and am content with your proposals for the handling of the announcement of your decision.

Copies of this letter go to recipients of yours.

Yours ever
Nigel

NIGEL LAWSON

DEPARTMENT OF EMPLOYMENT
Caxton House Tothill Street London SW1H 9NF

Telephone Direct Line 01-273 ...5176...
Switchboard 01-273 3000 Telex 915564
GTN Code 273 Facsimile 01-273 5124

P N Sedgwick Esq
HM Treasury
Parliament Street
London SW1

Your reference

Our reference

Date

2 March 1989

Dear Peter

RPI ADVISORY COMMITTEE REPORT

I attach a draft press notice. Could you let us have any comments by noon tomorrow?

Yours sincerely

MARTIN HARGREAVES

Assistant secretary to the Committee

Copies to
PPS
Sir P. Middleton
Sir T. Burns
Mr. Scholar
Mr. Peretz
Mr. Hibberd
Mr. Grice
Mr. O'Brien

Yes. Robert:
Otherwise this one OK.

Ch
I'd omit the whole of Para 7 of the Notes to Editors (which are much too long anyway). It contains some tendentious stuff

DRAFT PRESS NOTICE

3 March 1989

RETAIL PRICES INDEX ADVISORY COMMITTEE'S REPORT

The Government has decided to accept the recommendation of the Retail Prices Index Advisory Committee that the Community Charge should be included in the index when rates are abolished, from April 1989 in Scotland and a year later in England and Wales.

In answer to a Parliamentary Question from [ ] the Secretary of State for Employment, Norman Fowler, said:

> "The report is being published today. I have decided to accept all its recommendations. They will start to take effect in April when the Community Charge comes into operation in Scotland."

The report, entitled *Treatment of the Community Charge in the Retail Prices Index*, is available from Her Majesty's Stationery Office as Cm [ ], price [ ].

NOTES TO EDITORS

1. The Retail Prices Index Advisory Committee is convened from time to time by the Secretary of State for Employment to advise on the method of construction and compilation of the retail prices index (RPI). The Committee first met in 1947, when the present index was initiated, and had had ten series of meetings before the latest one. Virtually every aspect of index methodology has been examined at one time or another, and each major development which has taken place in the RPI over the last forty years has followed from the Committee's recommendations. For example in 1974 it recommended that mortgage interest payments should be included in the RPI for the first time, and in 1986 it defined how housing benefit should be treated in the index. The Committee's reports are generally published as command papers.

2. The Committee consists of representatives of consumers and employees, retailers and business interests, the academic community and government departments, meeting under the chairmanship of a senior official of the Department of Employment. The procedure has always been for conclusions to be reached by consensus. There has never been occasion for a minority report but the agreed reports which are submitted make clear where differences of view emerged within the Committee and what the competing arguments were.

3. On 17 October 1988 the Secretary of State announced that he was reconvening the Committee to advise him on the effect of the abolition of domestic rates on the construction of the RPI and the way that expenditure on holidays should be taken into account in the index, and to review progress on implementing longer-term recommendations made in the Committee's 1986 report. So far the Committee has had time to consider only the first of these issues: the others will be addressed in a second report to be submitted within the next twelve months.

4. The present report, which was submitted to the Secretary of State a week ago, reviews in some detail the basis on which rates are currently included in the index, the arguments for and against including the Community Charge once rates are abolished, and the different ways in which this might be achieved. The Committee's recommendation is that the Community Charge should be included in the index, in a similar way to that in which rates are treated now. A prime consideration in reaching this conclusion was the desire to sustain public confidence in the RPI, and a belief that this confidence might be set at risk if the Community Charge were excluded.

5. The incorporation of the Community Charge in the RPI, replacing rates, will not have a major much effect on the level of the index. It is estimated that, taking the changes in England, Scotland and Wales together, the "all items" index will rise by between 0.1 and 0.2 per cent more than it would have done if the same local authority expenditure had continued to be financed by the rating system. This effect arises because the households covered by the index will have to meet a larger share of total Community Charge payments than they did of rates. (See paragraphs 64 and 65 of the report.) Once the changeover has taken place the effect on the RPI of including the Community Charge will depend upon whether the Charge increases more or less quickly than the other items in the index and, in the Committee's view this cannot be predicted.

6. The report points out that, though the precise nature of the RPI's coverage will have changed once the Community Charge has been introduced, its essential character should remain the same. It will continue to measure changes in prices across the whole range of goods and services purchased for consumption by households.

7. Other key points in the report are:

a) The Community Charge can be seen either as a payment for services rendered by local authorities or as a tax. The Committee thought there was considerable justification for the former view, since the proceeds of the Charge will be used exclusively for the provision of local services, but it also recognised that the Charge - widely referred to as a "poll tax" - does have much in common with direct taxation of individuals. The report identifies a "middle way", saying that the Charge is something of a hybrid - a locally-oriented residence charge combining certain features both of a payment for services and of a direct tax. (See paragraph 17.)

b) The inclusion of the Community Charge in the RPI can be justified in several ways. In the first place it is, like rates, directly associated with the occupation of property: those occupying two houses will pay two Charges while homeless people will pay none. Secondly, the aggregate payments made will be closely related to the amount of services provided by local authorities: consumers in areas where a high level of services is provided will pay more than those in areas with less provision. Indeed the link between payments made and services provided will be closer under the Community Charge regime than under the rating system. (See paragraphs 29 to 32.)

c) The Community Charge has features in common with various items which are already included in the RPI, including television and motor vehicle licences, subscriptions and membership fees, standing charges for gas and electricity supply and telephone service, water and sewerage charges. The Committee commented that "It would be difficult to justify excluding such payments as these from the RPI, and the Charge evidently has much in common with them". (See paragraphs 34 to 37.)

d) The Committee recognised the possibility that local authorities might reduce their Community Charges very significantly by simply cutting services or reducing their standards. Some members thought that, if this were to happen, it would be quite inappropriate for the RPI to fall as a result and that, ideally, the index should be adjusted for changes in the volume of services provided. Other members thought such changes were likely to be small while some, viewing the Community Charge as a tax, felt it would be inappropriate to allow for them in any event. However, the whole Committee agreed that there is no method currently available which would enable changes in the volume of local authority services to be properly estimated, and recommended against making adjustments for them. (See paragraph 45 et seq.)

e) The Committee identified a particular problem which might arise if there were significant moves towards privatisation of what are currently local authority services, so that their cost was met directly by consumers rather than indirectly via the Community Charge. In this case the Committee said it would want steps to be taken to prevent a spurious fall in the level of the RPI. It therefore thought that the question of volume adjustment should be kept under review and that the Committee should be invited to look at the matter again in a few years' time. (See paragraph 51.)

f) In line with the treatment of other subsidies and discounts the Committee thought that, in compiling the RPI, no account should be taken of the Community Charge rebates which will be received by many people with relatively low incomes, or of the concession whereby students pay only 20 per cent of the full Charge. (See paragraphs 58 and 59.)

g) The Community Charge will form part of the "Housing" group within the RPI, as rates have always done. (See paragraphs 66 and 67.)

chex.ps/aa/29 **RESTRICTED**

FROM: A C S ALLAN
DATE: 3 March 1989

PW

MR SEDGWICK

cc Sir P Middleton
Sir T Burns
Mr Scholar
Mr Peretz
Mr Hibberd
Mr Gieve
Mr O'Brien

RPI ADVISORY COMMITTEE REPORT

The Chancellor has seen Mr Hargreaves' letter to you of 2 March. He feels that the whole of paragraph 7 of the Notes to Editors should be omitted: it contains several contentious points, and the Notes are much too long anyway.

ACSA

A C S ALLAN

CHANCELLOR OF THE EXCHEQUER

The CST must be robust.

The argument abt CC capping was ~~robust~~ prolonged, but the outcome was clear & decisive.

And in the end the PM came down v. firmly in support.

NL

CHANCELLOR OF THE EXCHEQUER

Ch

- I gather CST is a bit concerned about being isolated, and wants to concert with Mr Ridley if poss. See table @ X - I think it would be ludicrous, & convey all the wrong signals & precedents, if we did not have a go at Glasgow, Clydebank & Stirling at least – and preferably more. Arguments about poll tax 'failing' don't cut any ice – why do we have poll tax capping in legislation @ all if not for this sort of case

AA

CONFIDENTIAL

Ch/ Community charge capping would need very careful presentation; it could easily be seen as an admission the CC had failed in its objectives. The tendency for authorities to manipulate spending & reserves with the electoral cycle will not go away and I would be surprised if, once introduced, capping did not become a permanent device.
DJS

FROM: G C WHITE (LG1)
DATE: 26 APRIL 1989
EXT: 5731

1. MR POTTER (LG1)

2. CHIEF SECRETARY

cc: Chancellor
Sir P Middleton
Mr Anson
Mr Monck
Mr Phillips
Mr Edwards
Miss Peirson
Mrs Lomax
Mr MacAuslan
Mr A M White
Mr Hudson
Mr Call

Any proposal to introduce community charge capping will be controversial. (I am certain Mr Rifkind will oppose selective action in Scotland vigorously.) But, though the arguments are quite finely balanced, I believe there is a good case for capping at least in the short-term. And, in view of the Scottish figures, if the Government is to adopt capping, action will need to be taken this year.
RHP 26/4

COMMUNITY CHARGE CAPPING IN SCOTLAND

The Abolition of Domestic Rates Etc (Scotland) Act 1987 provides statutory authority for reducing community charges in Scotland. This process, known as "community charge capping", enables the Secretary of State to reduce community charges where he is satisfied that the expenditure of the local authority concerned is "excessive and unreasonable". Now that community charges have been introduced in Scotland the Government will need to decide whether or not any local authorities should be subject to community charge capping in 1989-90.

Background

2. In July 1987 E(LF) concluded that there should be a scheme for capping the community charge and that the approach for England and Wales should follow the proposals to be adopted in Scotland. The proposals in Scotland are based on the Scottish system of rate capping which has the considerable advantage of taking action in-year. This means that the Government selects authorities for capping at the beginning of the financial year and announces the amount of the reduction proposed so that authorities would have time to rearrange their expenditure plans for the remainder of the year.

CONFIDENTIAL

3. In deciding the authorities to be selected for community charge capping the Secretary of State has to look at a number of factors to determine whether the authorities' spending can be judged as "excessive and unreasonable". He has to look at the financial position of the authority, take account of spending in the year and in any preceding year, and may take account of any creative accounting devices used to reduce the burden on the charge payer. The exact criteria for determining which authorities should be selected for community charge capping has not been decided.

The situation in Scotland

4. Local authorities in Scotland have now set community charges for 1989-90. The average personal community charge is £280, which when added to the average water community charge of £21 gives an overall average community charge bill of £301. This represents a substantial increase of 14 per cent over the average domestic rate bill per adult in 1988-89.

5. Scottish local authorities have plans to increase spending in 1989-90 by 12 per cent over budgets for 1988-89 and, in addition, to build up balances ie most of the 14 per cent increase in income will be reflected in higher spending but some will feed through into increased balances.

6. So the community charge has not yet had any general restraining effect. There is however considerable variation between districts. Some of the traditionally high spending authorities seem to have felt under pressure to reduce the impact of the community charge, at least to keep it below psychologically important levels. But on the other hand some of the large increases in spending have come from authorities which have been moderate spenders in the past. It appears that they have taken the opportunity offered with the introduction of the community charge to boost spending and reserves.

The case for community charge capping

7. Under the new local authority financial regime we see community charge capping as potentially a key weapon in the battle to reduce local authority current spending. The Survey discussions are likely to focus on the amount of grant the Government needs to provide in support of a certain aggregate need to spend ie the total amount of local authority spending the Government is prepared to endorse. This will imply a figure for the community charge for spending at need and this is likely to be the figure that the Government will wish to publicise in the run up to the introduction of the community charge in England and Wales. The actual community charges that local authorities set are likely, of course, to be very different (usually higher) and here the Government will run the accountability argument. However the Government is likely to continue to plan public expenditure in terms of general government expenditure as a percentage of GDP and, as a result will want to continue to exert downward pressure on local authority spending.

8. The community charge regime is designed to exert downward pressure on spending through local accountability but it is unlikely that this will bite for some time. In the initial years of the community charge it will be difficult for the local electorate to relate changes in the community charge to changes in spending (because of the effect of the "safety net") and, in any case, they can only express their view through elections and these will not take place immediately. It will therefore take several years for accountability to take effect. In the meantime local authorities could well increase spending and lay the blame on the Government's community charge policy. Thus the use of community charge capping should be seen as a crucial component of the new regime and as an essential weapon against overspending. The Government cannot directly stop local authorities from overspending; community charge capping is the only means of stopping authorities levying excessive community charges.

9. In addition, high local authority spending and excessive community charges will tend to make more difficult the delivery, beginning next year, of the local authority contribution to the harmonisation of business rates between Scotland and England.

10. We also need to consider the implications for England and Wales and whether the use of community charge capping in Scotland will act as a deterrent in England and Wales. Mr Ridley has already agreed that a similar system of capping will be introduced in England and Wales. Hence, whatever is agreed in Scotland will have implications for the introduction of the community charge in England and Wales on 1 April 1990. If the Scottish situation is repeated in England and Wales, then local authorities are likely to increase both spending and reserves in 1990-91. This will lead to higher community charges and it will be important for the Government to have available a mechanism for constraining community charges. There is a risk that if nothing is done in Scotland, the implication will be that capping is not a real threat and the Government will be sending the wrong signals. If action is taken, this will emphasise the Government's continued concern and will act as a deterrent against overspending and the setting of high community charges.

11. Finally, the legal position means that the Secretary of State can reduce community charges where he is satisfied that the expenditure of the local authority concerned is "excessive and unreasonable". If no action is taken in 1989-90, when we believe spending is "excessive and unreasonable", we will have created a precedent that will make it difficult to sustain a case for action in later years.

The case against community charge capping

12. We strongly suspect that Scottish Ministers will not wish to introduce community charge capping in 1989-90. They will probably point to the accountability argument, and say that if authorities have overspent then they should be left to sort out their own problems. If the Government intervenes (they will say) then this will signal failure in the community charge policy and increase adverse publicity for the community charge.

13. They can also argue that the community charge brings a clear new discipline and that this should take effect as quickly as possible. If capping is introduced it may discourage authorities from taking difficult decisions to cut spending. Instead they will carry on spending recklessly in the expectation that the Government will let them off the hook by taking unpopular spending decisions for them.

14. In addition the Scottish Office may argue that because so many authorities have budgeted to spend at a relatively high level it would be difficult to select only a few authorities for capping on a consistent basis. (They would also argue that selecting too many authorities would be a substantial administrative burden).

Possible selection criteria

15. If we do decide to pursue capping, there are a number of possible ways of selecting authorities for capping - expenditure above needs, excessive year on year increases in expenditure, excessive year on year increases in income, etc. The Scottish Office have received legal advice which says that when selecting authorities for capping the Secretary of State must have regard to excess expenditure above assessed need. This means that in Scotland this must be the main basis for selection. Other factors can be taken into account but this must be the primary test.

16. Assuming that authorities are selected on the basis of excessive community charges (based on expenditure above needs) the following authorities in Scotland would be selected:

Scottish local authoriteies with expenditure more than 15% needs in 1989-90

	Expenditure above needs	Year on year increase in expenditure	Expenditure per head (£)	Community charge (£)
Expenditure above needs by				
More than 25%				
Glasgow	45%	35%	243	306
Clydebank	42%	20%	167	297
Stirling	35%	18%	164	310
Clydesdale	30%	24%	149	301
East Kilbride	27%	20%	141	318
Clackmannan	27%	32%	170	300
Between 20% and 25%				
Dumbarton	22%	14%	143	298
Aberdeen	20%	19%	146	304
Edinburgh	20%	19%	160	392
Argyll and Bute	20%	11%	155	277
Between 15% and 20%				
Monklands	18%	27%	155	293

17. There is a strong case for arguing that all authorities that are spending at more than 25 per cent above needs should be selected. Otherwise the implication is that spending at this level is acceptable. On this basis the top six authorities shown in the above table would be selected for capping.

18. Scottish Officials have carried out a very detailed analysis of the individual authorities, looking at volume growth and expenditure per head as well as the level of expenditure above need. Their conclusion is that if selective action were to be taken, the possible candidates would be Glasgow, Clydebank and Stirling. They would exclude Clydesdale, Dumbarton and East Kilbride on the grounds that their expenditure per head is below the district average. It would then be difficult to make a case against Aberdeen, Argyll, Clackmannan and Edinburgh. We would agree that if action is to be strictly limited Glasgow, Clydebank and Stirling are the appropriate candidates.

(but presumably their needs are below district average)

19. It is for Mr Rifkind to put forward proposals on selection, so rather than put this specific proposal to Mr Rifkind it might be better to suggest that you would welcome his own proposals but hint fairly strongly that you very much favour decisive action.

Timing

20. One of the most important features of the Scottish system is that the Government will be taking action in-year to reduce community charges. This means that the Government will be seen to be taking immediate action rather than react, as happens currently in England and Wales, to an authorities excessive spending plans for one year by limiting its expenditure by a cap on the charge in the following year.

21. The 1987 Act does not specify any restrictions on when the Secretary of State has to act. He cannot however leave it too late. The later a decision is taken the more difficult it becomes for a local authority to rearrange its expenditure plans and collect a different level of community charge. It would therefore be desirable for a final decision to be announced before the end of June. Local authorities would, of course, have prior warning in the sense that the Secretary of State would need to make an initial announcement some 4-6 weeks earlier. This would allow the authorities time to make representations and for these representations to be considered fully before taking a final decision. On this time-table his initial proposals would need to be put forward in the first half of May.

Conclusion

22. Community charge capping in Scotland is likely to be a controversial issue and it is likely that Scottish Ministers will resist any proposals for capping in 1989-90. We believe however that it is an essential weapon against excessive spending by local authorities and that it should be seen as an important part of the new financial regime. Given that Scottish Ministers are unlikely to want to take action in 1989-90, and may perceive an advantage in delaying any discussion, you may wish to take the initiative. There are however a number of ways forward

(a) Accept that it will be difficult to take action in Scotland in 1989-90 and do not write to Mr Rifkind;

(b) Write to Mr Rifkind explaining why capping is important but do not express a view on whether any authorities should be selected for capping in 1989-90.

(c) Propose that capping should be introduced in 1989-90, but leave the selection of authorities to Mr Rifkind.

(d) Propose that capping should be introduced in 1989-90, and suggest to Mr Rifkind the particular authorities that should be selected.

23. We are, of course, happy to discuss the various options. Our preference is for Option 3, and if you agree a draft letter for you to send to Mr Rifkind is attached.

24. This submission has been agreed with ST and GEP.

G C WHITE

DRAFT LETTER FOR THE CHIEF SECRETARY TO SEND TO MR RIFKIND

COMMUNITY CHARGE CAPPING IN SCOTLAND

Following the introduction of the community charge in Scotland on 1 April 1989, the information now available from local authorities on their budgets for 1989-90 and the community charges that they have levied, has lead me to consider how we should respond. You have no doubt been considering the same issues but I thought it might be helpful if I set out my own thoughts at this stage.

The facts are that Scottish local authorities have budgeted to increase their income by about 14 per cent in 1989-90 (compared to 1988-89); and they plan to increase their spending by 12% - a substantial increase of over 6% in real terms. Though the pattern has varied between authorities, the figures indicate that Scottish local authorities as a whole have used the introduction of the community charge as an excuse both to increase spending and build up reserves.

This is very disappointing and a most unfortunate signal in advance of the introduction of the community charge in England and Wales. We must not condone the actions of those authorities who have increased their spending in the belief that they can lay the blame on the Government's community charge policy.

The fundamental aim of our community charge policy is to improve accountability and so rein back the growth in local authority spending. If the local electorate is unhappy, then we would expect it to take action through the ballot box. In the fullness of time, we believe and expect that this will happen. But it is important to appreciate that accountability is bound to take time: some local authorities are inevitably going to seek to embarrass us by setting high community charges in the first year; the initial shift from the old domestic rating system rather blurs the accountability message (as of course does the limited safety net in Scotland); and there are no local elections in Scottish districts until 1992.

In the meantime I believe that it is important that central government should protect community charge payers and, at the same time, exert downward pressure on local authority current spending. We have both recognised, in our discussions on the harmonisation of business rates between Scotland and England, that there is both the scope and need for considerable reductions in the existing level of Scottish local authority spending. We need to be consistent in the signals that we give. At least in the short term, therefore, I see a case for the use of community charge capping against excessive spending.

Failure to act in Scotland this year runs the risk of signalling to Scottish local authorities that the Government will turn a blind eye to profligacy in later years. (Indeed if we implicitly accept that half a dozen councils can spend over 25% above needs now, the Scottish courts may well rule out capping for more modest spending in later years). It will also give a similar impression to English and Welsh local authorities during their first year of the community charge in 1990-91.

Given the large number of councils in Scotland which have budgeted to spend at much increased levels this year it will be difficult to devise selection criteria to catch the right authorities. Clearly the selection criteria are crucial. It will be important to select on a rational and defensible basis that leads to action against those councils which we believe have acted most irresponsibly in 1989-90. Based on such figures as we have seen this would suggest capturing up to six of the worst offenders. But you are much better placed to advise on the right selection and I would welcome proposals on what you would consider the best option to be. Given the time constraints on capping, we will of course need to move quickly.

Community charge capping will be a controversial issue. But we must demonstrate that excessive local authority spending, and burdens on local taxpayers, are no more acceptable under the new regime than they were under the old. I would welcome your views on how you think we should proceed.

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

J.M

FROM: D I SPARKES
DATE: 28 APRIL 1989

BF ~~11~~ 8/5

PS/CHIEF SECRETARY

pmp

COMMUNITY CHARGE CAPPING IN SCOTLAND

The Chancellor has seen a copy of Mr White's submission to the Chief Secretary of 26 April considering whether or not local authorities in Scotland should be subject to community charge capping in 1989-90.

2. The Chancellor suggests the Chief Secretary should take a robust line. He commented that the argument about community charge capping was prolonged but the outcome was clear and decisive. And in the end the Prime Minister came down very firmly in support.

D.I.S.

DUNCAN SPARKES

cst.ps/3jm3.5/drfts

CONFIDENTIAL

cc:
Chancellor
Sir Peter Middleton
Mr Anson
Mr Monck
Mr Phillips
Mr Edwards
Miss Peirson
Mrs Lomax
Mr Potter (LG1)
Mr G C White (LG1)
Mr MacAuslan
Mr A M White
Mr Hudson
Mr Call

Treasury Chambers, Parliament Street, SW1P

The Rt Hon Malcolm Rifkind QC MP
Secretary of State for Scotland
Scottish Office
Dover House
Whitehall
London
SW1A 2AU

3rd May 1989

Dear Malcolm

COMMUNITY CHARGE CAPPING IN SCOTLAND

Following the introduction of the community charge in Scotland on 1 April 1989, the information now available from local authorities on their budgets for 1989-90 and the community charges that they have levied, has lead me to consider how we should respond. You have no doubt been considering the same issues but I thought it might be helpful if I set out my own thoughts at this stage.

I understand that Scottish local authorities have budgeted to increase their income by 14 per cent in 1989-90 (compared to 1988-89); and they plan to increase their spending by 12 per cent - a substantial increase of over 6% in real terms. Despite a small real increase in assessed need to spend between the two years, local authorities in Scotland are now overspending relative to needs by nearly twice as much in 1989-90 (-8.6 per cent), as they were in 1988-89 (+4.5 per cent). As the Press Notice issued by your office on 13 March indicated, a number of previously low-spending authorities have taken the opportunity to raise their spending to the assessed needs figure.

I appreciate that the pattern has varied between authorities. But on the whole the figures indicate that Scottish local authorities have used the introduction of the community charge as an excuse for a substantial real rise in spending; to increase the degree of overspending; and to build up reserves. Perhaps you can confirm that this is your understanding too.

CONFIDENTIAL

This is very disappointing and a most unfortunate signal in advance of the introduction of the community charge in England and Wales. We must not condone the actions of those authorities who have increased their spending in the belief that they can lay the blame on the Government's community charge policy.

The fundamental aim of our policy is to improve accountability and so rein back the growth in local authority spending. If the local electorate is unhappy, then I would expect it to take action through the ballot box. In time, I am sure this will happen. But it is important to appreciate that accountability is bound to take time: some local authorities are inevitably going to seek to embarrass us by setting high community charges in the first year; the initial shift from the old domestic rating system rather blurs the accountability message (as of course does the limited safety net in Scotland); and there are no local elections in Scottish districts until 1992.

In the meantime I believe that it is important that central government should protect community charge payers and, at the same time, exert downward pressure on local authority current spending. We have both recognised, in our discussions on the harmonisation of business rates between Scotland and England, that there is both the scope and need for considerable reductions in the existing level of Scottish local authority spending. We need to be consistent in the signals that we give. At least in the short term, therefore, I see a case for the use of community charge capping against excessive spending.

Failure to act in Scotland this year runs the risk of signalling to Scottish local authorities that the Government will turn a blind eye to profligacy in later years. Indeed if we implicitly accept that half a dozen councils can spend over 25 per cent above needs now, the Scottish courts may well rule out capping for more modest spending in later years. Even if they do not, it might be politically difficult for us to pursue such options even though they were justified. I fear too that if we neglect to act in Scotland now, that will be taken as an indication that the same leniency will apply in England and Wales next year. I assume that Nick Ridley will have views on this point also.

Given the large number of councils in Scotland which have budgeted to spend at much increased levels this year it will be difficult to devise selection criteria to catch the right authorities. Clearly the selection criteria are crucial. It will be important to select on a rational and defensible basis that leads to action against those councils which we believe have acted most irresponsibly in 1989-90. Based on such figures as we have seen this would suggest capturing up to six of the worst offenders. But you are much better placed to advise on the right selection and I would welcome proposals on what you would consider the best option to be. Given the time constraints on capping, we will of course need to move quickly.

I recognise, of course, that community charge capping will be controversial. But we must demonstrate that excessive local authority spending, and burdens on local taxpayers, are no more acceptable under the new regime than they were under the old. I would welcome your views on how you think we should proceed.

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

Yours Ever
John

JOHN MAJOR

CH/EXCHEQUER

REC. 11 MAY 1989

~~ACTION~~ MR REDMAN

COPIES TO MR PORTEOUS

MR CLUEY -RGPD

/11/5

pwp

(on BF)

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

10 May 1989

Dear Alan,

COMMUNITY CHARGE LIABILITY

Thank you for your letter of 5 May in which you provided a note about the treatment, for community charge purposes, of the various residences occupied by the Prime Minister. The Prime Minister was grateful for this material. She feels it would not be appropriate at this stage to use the whole of the material in the note in dealing with press enquiries, but she has agreed that the No. 10 press office should draw on the attached note. She envisages that, once the various charging authorities have reached their decisions, a more forthcoming response would be given.

I am copying this letter to Duncan Sparkes (HM Treasury), Joe Donovan (Rating of Government Property Department) and Trevor Woolley (Cabinet Office).

Yours

Paul

(PAUL GRAY)

Alan Ring, Esq.,
Department of the Environment.

SW2AVB

LIABILITY OF PRIME MINISTER AND MR. THATCHER TO COMMUNITY CHARGE

1. The Prime Minister and Mr. Thatcher will obviously be liable to a personal community charge like everyone else.

2. The precise assessment of liability both for the personal charge and for second homes rests with the relevant charging authorities; it is for them to reach the final decision on which is the Prime Minister's main residence. The registration forms in relation to No.10 and Dulwich will be completed in the normal way so that the charging authorities can make their determinations.

3. The position at Chequers will be handled by the Trustees in conjunction with the relevant charging authority.

4. [If specifically asked] The Thatchers have returned a completed form in relation to Dulwich.

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~~ Security

CONFIDENTIAL

pmp

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

16/5 15 May 1989

Dear John,

COMMUNITY CHARGE CAPPING IN SCOTLAND

Thank you for copying to me your letter to Malcolm Rifkind of 3 May.

Any reduction in the community charge levels set by Scottish local authorities following the introduction of capping would, of course, lead to consequential reductions in Community Charge Rebate entitlement of everyone who had claimed from those authorities, and this in turn would reduce this Department's expenditure on Community Charge Rebate Subsidy to a level closer to our forecast. The Community Charge Rebate Regulations already provide for the recalculation of rebate entitlement in such circumstances, but the recalculation would increase both the workload and the administrative expenditure of Scottish authorities at a time when they are already hard pressed. I do not anticipate any difficulty in resisting the pressure we could expect for increased administrative subsidy, but it would undoubtedly add to the controversy you envisage.

Any measure that would help to contain Community Charge levels in England and Wales is to be welcomed, both because it would contain expenditure on rebates, and also because it would reduce the instances where the 20% minimum Community Charge payment was in excess of the help we have provided in Income Support.

I am copying this letter to Malcolm Rifkind, to other members of E(LF), and to Sir Robin Butler.

Yours ever
John

JOHN MOORE

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB
01-276 3000

My ref:
Your ref:

CH/EXCHEQUER 17/5
REC. 17 MAY 1989
ACTION CST
COPIES TO

PMP

The Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1

16 May 1989

Dear Chief Secretary

COMMUNITY CHARGE CAPPING IN SCOTLAND

I have seen your letter of 3 May to Malcolm Rifkind about community charge capping in Scotland.

You mention possible implications for us in England next year of decisions taken now about charge capping in Scotland. As you know, we have always said that we hope we never need to use our capping powers, but equally we have made clear that if it proves necessary we shall not shrink from capping those authorities which, for whatever reason, decide to budget excessively. English authorities have in the past taken the threat of capping seriously, and I believe this will continue to be a significant restraining influence on authorities as they budget for 1990/91. This influence will be particularly important in the first year of the new system when authorities may be tempted to spend up, taking advantage of the blurring of accountability by the transitional safety net arrangements. I would therefore be concerned about any decisions which might lead authorities to doubt our resolve to cap excessive spenders.

Having said this, I believe there is only limited read across between what happens in Scotland this year and the English situation. The circumstances of Scottish authorities are very different, and hence I see no great risk that decisions taken now for Scottish authorities about selection criteria, or about the size of caps, will set precedents from which politically we would find it difficult to depart when next year we come to consider capping in England. Furthermore, in Scotland there is different legislation with materially different capping powers (Malcolm's powers enable him to cap authorities whose spending is excessive and unreasonable, whilst I will be empowered to cap those whose spending is simply excessive); there is no question of Scottish colleagues' decisions forming legal precedents for us in England. A decision against capping any Scottish authorities this year might be taken as a signal of our intentions for England, but would not, I believe, undermine our position to any great extent. Clearly, a decision to cap in Scotland could be used by us to underline our resolve to use capping if necessary next year here.

Accordingly, the principal factor in any decision to cap this year must be the Scottish situation. The picture which emerges from your letter is one where authorities there generally have budgeted a disappointing high levels, with a few authorities budgeting at levels which can only be regarded as profligate. In such circumstances I believe the case for capping is strong, although I agree that Malcolm is much better placed to advise on the details of selection criteria. And as you say, if we are to cap authorities successfully this year, we need now to move very quickly.

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

Yours sincerely

pp NICHOLAS RIDLEY

(Approved by the Secretary of State
and Signed in his Absence)

CH/EXCHEQUER 18/5

18 MAY 1989

CST

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

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

18 May 1989

Ch/ To note Mr Rifkind is resisting CC capping largely on grounds it would make little difference to the total overspend in Scotland - very dubious logic. Mr Ridley's letter (behind) is also unhelpful: he denies a lead-across between Scotland & England.
DJS

Dear John

COMMUNITY CHARGE CAPPING IN SCOTLAND

Thank you for your letter of 3 May.

As you surmise, I have been giving a good deal of thought to Scottish local authorities' budgeted overspending this year and whether it would be appropriate to respond by using my community charge capping powers. As you would expect, there are some very conflicting considerations.

The overall picture is of budgeted expenditure 11.4% higher than budgets for 1988-89. This clearly involves a real terms increase - though, bearing in mind new burdens imposed since last year (including in particular school boards and community charge collection) and also that actual rates of inflation experienced by local authorities will have been higher than GDP or RPI figures, the volume increase will not be so high as 6% - perhaps 3.5% to 4%. In accordance with experience in past years, I would expect actual expenditure by the end of the year to be somewhat lower than this.

I was interested in your speculations as to the reasons for this. My own view, based on post-mortem discussions which my officials have had with senior local authority staff and on a meeting that Ian Lang and I had with the Convention of Scottish Local Authorities 2 weeks ago, is that several factors were involved. In the first place, the ending of grant penalties must have had some impact. Second, the change in grant arrangements will have been seen by some authorities as providing an opportunity to increase their spending while obfuscating the reasons for the increase. Third, I think that many local councils have seen all too clearly the pressure that community charge arrangements will quickly bring to bear on their spending arrangements, and will have decided on a last burst for growth while they felt that the going was still good. There is certainly evidence that the 2 traditionally high spending authorities - Lothian and Strathclyde Regions - went to enormous efforts (albeit starting far too late in the last financial year) to tailor their budgets to what they regarded as acceptable community charge levels.

You will gather from this that, while Scottish authorities' budgeting for this year is very disappointing, I do not think we need be unduly depressed about it. It is against that background that I have been considering use of the charge capping powers.

You will be familiar, from our exchanges in previous years, with the legislative background and constraints. The statutory test for using the charge capping power is whether an authority's planned expenditure is "excessive and unreasonable". In reaching a view on this I must have regard to the financial and other relevant circumstances of the area of the authority; and in addition I may have regard to other considerations including the expenditure or planned expenditure of other comparable authorities in the year concerned or in any preceding year, general economic conditions, and "such other financial, economic, demographic, geographical and other criteria" as I consider appropriate.

In practice, in the absence now of expenditure guidelines, I have to have regard to "the financial and other relevant circumstances of the area" by reference to assessed needs; and the other factors are taken into account by comparing each authority which may be a candidate for capping with comparable authorities in respect of its increase in expenditure over the previous year, its increase in expenditure volume over the previous year and over a longer period, and its expenditure per head on the same basis. The comparator authorities for Regions are (because of their small total numbers) all other Regions with the same range of functions, but for District Councils the establishment of comparator authorities is itself a fairly complex statistical exercise.

These procedures have been refined over the years, and have been the subject from time to time of detailed consultation with the Scottish Law Officers. In particular, in the Scottish legislation the test of "unreasonableness" is in addition to the test of being "excessive". We take the view that "unreasonable" is to be construed in the Wednesbury sense as meaning so unreasonable that no reasonable person would plan such expenditure. This has generally been regarded as a very strict test.

All this will be familiar to you - and certainly to your officials - but I have thought it worth setting out in some detail for a very good reason. The care with which I and George Younger before me have exercised these powers has meant that we have never yet been challenged in the Courts. I would be particularly reluctant to cut any corners in the procedure this year when authorities may be more than usually liable to challenge me, and when any adverse court decision would be particularly damaging for future use of the powers.

On that basis, I am quite clear that I could not take action against any of the Regional Councils. Their average budget to budget increase is 10.5%, against which the highest increase is Highland's at 13.5% but they are only 3.6% over their assessed need which is well below the Regional average. In the case of Lothian their increase is 11%. But their volume increase is the lowest of all Regional authorities, both over a one and a 5 year period, and their expenditure per head is below the regional average.

The District Council position is different and, as your officials will have advised you, there are certainly several District Councils reporting substantial budget to budget increases. Your officials have a detailed working paper which identifies 3 District Councils as candidates for capping. You ask if I could adjust the criteria in order to throw up around 6 candidates. Quite apart from the legal impropriety of exercising a discretionary power in that way I could only do so if I was to set aside part of my well established and defensible scrutiny tests. To do so would in my judgement only increase the risk of challenge. But even as regards the 3 identified by the scrutiny, the issues are not entirely straightforward. In particular, Glasgow's budget includes provision for substantial expenditure on a one-off basis, related to the City's designation next year as European "City of Culture". There would be very obvious difficulties in taking action against Glasgow in these circumstances. That leaves me with Clydebank and Stirling District Councils, against whom clear cases for action could certainly be sustained.

Obviously, I have thought carefully about proceeding with these 2 authorities. But I am far from clear as to the advantages of doing so, and I see considerable disadvantages. The main practical point is that capping these 2 authorities would make very little difference to the total budgeted overspend by Scottish authorities - about £3.5 million, out of total budgeted expenditure of £4126 million. It is hard to believe that this would have any desirable demonstration effect on other authorities. It may, indeed, simply point up the limitations on the practical application of these powers. As you say the fundamental objective is to establish better accountability. We should give accountability a chance to work. Obviously, as you recognise, any community charge capping will be controversial. It would also undoubtedly generate a good deal of criticism, which is likely to focus on our abandonment of local accountability. The practical question is whether it is worth stirring controversy for such little return. My own feeling is that, unless we can use the capping powers to make a substantial difference to spending levels or to make some very clear political point, it is not worth doing and we simply risk bringing the underlying philosophy of the new system into disrepute.

There are 2 other aspects to the issue. The first, which you recognise in your letter, is the risk of giving the wrong signals in respect of future years; and there may also be some risk that failure to take action this year could prejudice future action, in a legal sense. But I think that it will be perfectly possible to elaborate counter arguments (if we are ever required to do so) on the basis that the circumstances in this first year of the new arrangements are exceptional; that action - or lack of action - this year is attributable to the changeover and the need to let the new system settle down; and that my decisions this year offer no necessary precedent for future years.

The other question is whether, if I fail to use the powers this year, this will create any awkward precedent for Nicholas Ridley next year. I cannot see that it would. My capping powers are of course unchanged in substance from those that I had under the rating system, and their use has been well established in rate capping over a number of years. Second, as I understand it, Nicholas faces a number of far-left authorities in England who pose problems of quite a different order from those which I face. Third, in determining whether a Scottish authority's expenditure is "excessive and unreasonable", what I undertake is a comparative exercise in which the comparators are other relevant Scottish local authorities with similar assessed needs. I have never compared expenditure of a Scottish with that of an English authority and, of course, there would be no basis for doing so since our needs assessment arrangements are different. All of these points could apply equally in reverse. And finally, the new English capping legislation (benefiting from our experience) operates by reference only to expenditure being "excessive" - ie the statutory test in England is different. In his letter of 16 May, Nicholas recognises that a read across from the Scottish situation is unlikely.

In the light of all these points I do not propose to undertake any charge capping this year. But one point that does occur to me, on looking at the matter again in the light of your letter, is that I should perhaps take an early opportunity to make clear that this decision should not be taken as a precedent for the future. I will look for an early opportunity to make this point, either in a public speech or in one of my forthcoming meetings with the local authority associations.

I am copying this letter to members of E(LF), to the Lord Advocate, and to Sir Robin Butler.

MALCOLM RIFKIND

PMP

SECRETARY OF STATE FOR THE ENVIRONMENT

CONFIDENTIAL

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

CHIEF SECRETARY	
REC.	24 MAY 1989
ACTION	Mr B White
COPIES TO	CX, Sir P Middleton, Mr Anson, Mr Monck, Mr Phillips, Mr Edwards, Mr Potter, Miss Peirson, Mr Lennox, Mr MacAuslan, Mr AM White, Mr Hudson, Mr Call

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

23 May 1989

Dear Chief Secretary,

Malcolm Rifkind sent me a copy of his letter of 18 May to you in response to yours of 3 May.

As I said in my letter of 16 May to you the main factor in determining whether or not to cap Scottish authorities this year must be the situation in Scotland itself.

My immediate concern, however, is the suggestion that if it is decided not to cap any authority Malcolm might publicly imply that capping had not been used as it would be inappropriate until the new system had settled down.

As I said previously, I believe there is only limited read across between Scotland and England and I accept Malcolm's argument that decisions about capping Scottish authorities this year will not in themselves create an awkward precedent for decisions about capping in England next year. But any announcement of a decision not to cap in Scotland which implies that capping would be inappropriate in the first year of a new system could create difficulties for me. Such a suggestion could leave us open to the accusation of inconsistency of approach, notwithstanding the different situation in Scotland and England, if it were decided to charge cap in England next year. It could also give rise to a clear expectation that we would not cap in England in 1990/91.

In these circumstances, I would urge Malcolm not to imply any such suggestion in any public justification of a decision not to cap in Scotland this year. Indeed, from my point of view it would be much better not to make any announcement giving reasons for not capping Scottish authorities this year, if that is to be the decision.

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

Yours sincerely

PP

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

BF 5/6

CONFIDENTIAL

~~RE 26/5~~

FROM: A J C EDWARDS (LG)
DATE: 24 MAY 1989
EXT: 4480

CHIEF SECRETARY

cc Chancellor
Sir P Middleton
Mr Anson
Mr Monck
Mr Phillips
Mrs Lomax
Miss Peirson
Mr MacAuslan
Mr Potter
Mr A M White
Mr Hudson
Mr G C White
Mrs Chaplin
Mr Call
Miss Wheldon TSol
Mrs Dayer TSol

Ch/ CST is being advised to forewarn PM at your meeting tomorrow that an early meeting with Mr Rifkind should be called on this subject.
DJS

COMMUNITY CHARGE CAPPING IN SCOTLAND

Mr Rifkind's letter of 18 May rejects the suggestion that any Scottish local authorities should be charge-capped this year. He offers instead (not very seductively) to make clear publicly that this should not be taken as a precedent. Mr Ridley's somewhat indecisive letter of 16 May, clearly influenced by the thought that he may be having a similar argument with you in a year's time, says that, although inaction in Scotland "would not, I believe, undermine our position to any great extent", he believes "the case for capping is strong". His subsequent letter of 23 May argues strongly against an announcement suggesting that capping would be inappropriate in the first year of the new system.

you have not read this yet

Suggested way ahead

2. We do not think it would be right to let Mr Rifkind get away with no capping. The issue has strategic importance for the Community Charge policy. Although the basic assumption of the policy has always been that accountability should restrain expenditure at local level, accountability can hardly be expected to work properly in the early years and will indeed tend to work perversely, with many authorities blaming on the Community Charge

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policy high community charges resulting from high levels of expenditure.

3. There are two particular reasons why we think it important that there should be charge capping in Scotland this year.

4. First, as Mr Rifkind himself significantly admits, inaction this year will make it more difficult from a legal point of view to act in Scotland in later years. If the Government turns a blind eye this year to local authorities which overspend needs by over 40 per cent in some cases, it will be difficult in future years to defend on legal grounds capping any authority which overspends up to such levels. Consistency is critical, not least in the context of judicial review cases.

5. Second, the political signal from a decision to cap Scottish authorities this year would be extremely valuable; the signal from failure to cap, correspondingly damaging. Mr Rifkind is highly sensitive to arguments that English and Welsh repercussions should affect Scottish policies. This is, however, an immensely important consideration. If the Government turns a blind eye in Scotland this year, local authorities in England will be encouraged to call the Government's bluff next year. Of course there are differences of system and law between Scotland and England. It is, however, the same Government.

6. In the light of the above, we think that you should press hard for charge-capping in Scotland this year. Mr Rifkind will not concede the point in response to a further letter from you. The only way to resolve the matter, as we see it, will be to bring in the Prime Minister. We understand that No.10 are not proposing to intervene until requested to do so. We suggest accordingly that you should reply to Mr Rifkind, with a copy to the Prime Minister, suggesting that the Prime Minister should call an early meeting. You will wish to copy your letter to Mr Ridley and presumably Mr Parkinson as well. You may wish to consider whether it should be copied to Mr Walker. A draft letter is attached.

7. An alternative possibility would be to suggest an early meeting of E(LF). But E(LF) contains several Ministers who are not closely concerned. Moreover, time is running out: nearly two months of the financial year have passed already. For both reasons, a smaller informal meeting, called by the Prime Minister as soon as possible, would seem preferable.

8. If you agree, you may also like to foreshadow this important issue at your meeting with the Prime Minister tomorrow. In agreeing with Mr Ridley's point that the Government will need to be ready to charge cap next year, you could usefully make passing reference to the importance of preparing the way by capping certain authorities in Scotland this year.

Legal and technical points

9. The draft letter will, I trust, be self-explanatory. There are, however, two glosses which should be added.

10. First, the options. We have investigated Mr Rifkind's point about Glasgow's "European City of Culture" expenditure. The Scottish Office say that this expenditure amounts to £15 million this year. There is no needs assessment for such expenditure. Hence removing this from the calculation would (they say) reduce Glasgow's overspend above needs from 45% to about 30%, less than Clydebank and Stirling and on a par with Clydesdale. The accompanying table shows the figures.

11. It is for consideration whether expenditure on the "European City of Culture" should be differently treated from expenditure on other worthy causes. The fact is that Glasgow's Community Charge payers are being asked to pay a charge based on planned expenditure 45% above assessed needs. As can be seen from the accompanying table, the neatest solution would be to dodge this problem by capping either the six authorities whose planned expenditure exceeds assessed needs by 25% or more or the four authorities whose planned expenditure exceeds assessed needs by 30% or more. Glasgow would be included on either approach. Mr Rifkind will clearly argue strongly, however, for limiting any

Scottish local authorities with expenditure more than 25% above needs in 1989-90

	Expenditure above needs	Year on year increase in expenditure	Expenditure per head (£)	Community charge (£)
Glasgow	45%	35%	243	306
Clydebank	42%	20%	167	297
Stirling	35%	18%	164	310
Clydesdale	30%	24%	149	301
Glasgow, adjusted for culture	[30%]	[21%]	[217]	[280]
East Kilbride	27%	20%	141	318
Clackmannan	27%	32%	170	300

capping to Clydebank and Stirling. Meanwhile, it would seem legitimate to raise the question whether he would really be justified in exempting Glasgow, with a 45% total excess of spending over need, and whether such an exemption would make it more difficult to defend charge-capping Clydebank and Stirling, from both a political and a legal point of view.

12. Second, the legal position. We are much concerned about the interpretation which Mr Rifkind seeks to put on the charge capping criterion in the legislation, that a local authority's planned expenditure must be "excessive and unreasonable": the English counterpart legislation drops the words "and unreasonable". If an "unreasonable" level of expenditure really has to be construed in the extreme sense of "so unreasonable that no reasonable person would plan such expenditure", as suggested in the middle of page 2 of his letter, Community Charge capping in Scotland could be virtually a non-starter, and Mr Rifkind ought never to have retained this phrase in his legislation in the first place.

13. Past experience suggests that Scottish lawyers will be very difficult to shift on such a point. However, the Government has successfully rate-capped Scottish local authorities in times past, as well as using the threat of rate-capping to persuade authorities to negotiate a settlement. Having consulted informally with our own legal advisers, moreover, we think that a less extreme interpretation of the word "unreasonable" may be possible given the list of criteria which the legislation requires the Secretary of State to take into account.

not a lot of comfort

14. Certainly it would seem quite wrong to be deterred by fears of possible judicial review proceedings from applying the charge capping policy in the way intended. There is no point, as Bismarck put it, in committing suicide for fear of death.

AJCE

A J C EDWARDS

DRAFT LETTER FROM CHIEF SECRETARY TO:

Rt Hon Malcolm Rifkind
Secretary of State for Scotland

Community Charge Capping in Scotland

I am grateful for your letter of 18 May and Nick Ridley's letters of 16 and 23 May.

2. Although I well understand your preference for avoiding charge-capping, I see this as a key strategic issue in relation to the Community Charge policy as a whole.

3. The fact is that three Scottish local authorities have budgeted to spend between 35 percent and 45 percent above assessed needs and three more at between 27 percent and 30 percent above assessed needs. As you yourself imply, some Scottish authorities have clearly seen introduction of the new system of local government finance as providing an opportunity to step up their spending while blaming the Government.

4. From a legal point of view, you have confirmed that inaction this year could prejudice action in future years. I see this as a major concern. With respect, I do not think that an announcement that inaction should not be taken as a precedent would solve the problem; and Nicholas Ridley has pointed out the particular disadvantage in making any announcement which could be taken to imply that capping would be inappropriate in the first year of the new system.

5. I agree of course that we must be alive to the risks of judicial review. We should not, however, in my view, allow that to deter us from acting as the situation demands. Our aim this year (as in previous years) should rather be to minimise the risks by consistency of action, both as between one year and another and as between individual authorities, and by punctilious observance of procedures. I note what you say about interpretation of the

"excessive and unreasonable" levels of planned expenditure mentioned in the legislation. However, we have successfully rate-capped Scottish authorities in times past or brought them to the negotiating table. I believe we ought also to consider further whether the test of what is an "unreasonable" level of expenditure would have to be as exacting as that mentioned on page 2 of your letter, bearing in mind the criteria which you are required to take into account in reaching your capping decision.

6. At a political level, we should not in my view allow our bluff to be called by authorities who decide to spend up and blame the resulting burdens on introduction of the Community Charge. As implied in Nick Ridley's earlier letter, that would transmit a most unfortunate signal to local authorities throughout Britain.

7. As noted in my earlier letter, you are better placed than I to identify the options. Apart from your preferred option of <u>no</u> capping, however, I suspect that the main options may be to cap authorities exceeding their assessed need to spend by (a) 35% or more, (b) 30% or more, or (c) 25% or more. Also for consideration is whether you would really be justified in discounting Glasgow's European "City of Culture" expenditure and whether such treatment would make it difficult, from a political and legal point of view, to defend charge-capping other authorities. Depending on how that issue is resolved, options (a), (b) and (c) would I believe imply capping 2 or 3, 4 or 6 authorities, respectively.

8. We need in my view to weigh these matters carefully with the colleagues most closely concerned. I hope that, given the importance and urgency of the subject, the Prime Minister might find it possible to call an early discussion.

9. I am copying this letter to the Prime Minister, Nicholas Ridley, Cecil Parkinson, [Peter Walker], and Sir Robin Butler.

cst.ps/7ce26.5/mins

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CHIEF SECRETARY TO THE TREASURY

FROM: MISS C EVANS
DATE: 26 May 1989

MR EDWARDS

cc: Chancellor
Sir Peter Middleton
Mr Anson
Mr Monck
Mr Phillips
Mrs Lomax
Miss Peirson
Mr MacAuslan
Mr Potter
Mr A M White
Mr Hudson
Mr G C White
Mrs Chaplin
Mr Call

Miss Wheldon T Sols
Mrs Dayer T Sols

COMMUNITY CHARGE CAPPING IN SCOTLAND

The Chief Secretary was grateful for your submission of 24 May. I understand from Paul Gray that the Prime Minister is reluctant to intervene on this, and if required to do so, seems unlikely to support us. In the light of this, the Chief Secretary sees two options:

(a) to write anyway on the point of principle, and be overruled, possibly in unhelpful terms.

(b) agree at official level gruesome warnings that Mr Rifkind could issue (and has promised to, on future policy).

2 The Chief Secretary would be grateful for advice on which course to take. He is mildly inclined to (b) but prepared to be persuaded otherwise. He is also concerned that we are fighting a number of battles at the moment and need to choose carefully which ones we refer to the Prime Minister.

CE

MISS C EVANS
Private Secretary

FROM: A J C EDWARDS (LG)
DATE: 26 MAY 1989
EXT: 4480

CHIEF SECRETARY

cc Chancellor
Sir P Middleton
Mr Anson
Mr Monck
Mr Phillips
Mrs Lomax
Miss Peirson
Mr MacAuslan
Mr Potter (o/r)
Mr A M White
Mr Hudson
Mr G C White
Mrs Chaplin
Mr Call

Miss Wheldon TSol
Mrs Dayer TSol

please obtain X for me and then BF 5/6 when I return.

COMMUNITY CHARGE CAPPING IN SCOTLAND

X Miss Evans' minute of today records your request for further advice on this difficult matter.

2. I do of course understand your concern not to take too many battles to the Prime Minister. Paul Gray's advice to Miss Evans must add to this concern. I do not think, however, that it would be right to be overly influenced by this. Paul Gray is presumably judging what the Prime Minister's reaction might be in the light of the skilfully drafted minute from Mr Rifkind and other views at No.10. I understand that the political advisers there believe that the Community Charge has bedded down quite well in Scotland and are anxious not to risk upsetting things there.

3. I also take your point that, if there were an option to protect the flank effectively by having Mr Rifkind issue gruesome warnings, that would have some attractions. Sadly, however, our view is that gruesome warnings would do very little good and would probably indeed be harmful. As Mr Ridley's second minute argued, such warnings could be counterproductive. The only plausible excuse one can offer for not capping authorities who are spending more than 40 percent in excess of assessed needs is that this is

the first year of a new system. That, however, would send an appalling signal about the Government's posture and firmness of purpose. The hard fact is, I fear, that the Government does set a precedent by what it does in Scotland this year. It is both a legal precedent (in Scotland) and a political precedent (throughout the country). There is no way of undoing the precedent by saying it is not a precedent.

4. It was against this background that my earlier submission suggested that you needed to refer the matter to the Prime Minister and to write back to Mr Rifkind accordingly. We still think it would be wrong to give in to Mr Rifkind on such a strategic issue and in relation to such a strategic policy without bringing in the Prime Minister.

5. The chances of success may be no more than about 50/50. But we do have Mr Ridley more or less on side. I would also guess (no more) that Mr Rifkind and his officials will be pleasantly surprised if they get away with no capping. The Scottish local authorities concerned have raised their expenditure by amounts varying between 20 percent and 35 percent compared with last year to levels between 27 percent and 45 percent above their assessed needs.

6. As I mentioned to Miss Evans, time is now of the essence. Nearly two months of the financial year have passed, and Mr Rifkind will soon be able to argue that it is anyway too late for action. If therefore you do decide to write in the sense suggested, the sooner your letter can issue, the better.

7. I hope these further reflections will be of some help.

AJCE

A J C EDWARDS

 Seen by Hudson, White,

CH/EXCHEQUER 31/5
REC. 31 MAY 1989
ACTION No Copies to be taken
COPIES TO

bt 5/6

PWP

[Ask Plumpton if we can take one copy to give to LG]

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

26 May 1989

Dear Roger,

LOCAL AUTHORITY GRANT SETTLEMENT 1990/91

The Prime Minister held a meeting on Thursday 25 May to discuss your Secretary of State's minute of 22 May about the local authority grant settlement for 1990/91. Those present were your Secretary of State, the Chancellor of the Exchequer, the Secretary of State for Energy, the Chief Secretary, Treasury, Sir Robin Butler, Richard Wilson, George Monger and Andrew Wells (Cabinet Office) and John Mills (Policy Unit).

I should be grateful if you would ensure that this letter is seen only by those with a clear need-to-know and that no copies are taken.

GRAY TO BRIGHT NOTE OF MTG 25 MAY

Your Secretary of State said that the settlement for 1990/91, the first year of the community charge in England, would be particularly important and difficult. The immediate issues for decision were the aggregate figures to be announced in July: the overall total of needs assessments, and the amount of Aggregate Exchequer Finance (AEF) which the Government would make available to finance that spending. These two figures would imply a particular community charge for spending at need (CCSN). But Ministers would also need to consider what local authorities were actually likely to spend in 1990/91, and the actual community charges which would result.

The paper set out four options for total needs and AEF, which had resulted from discussions he had held with the Chief Secretary. His own preference was for option D, with total needs set 4 per cent above 1989/90 budgets, plus an extra £200 million for community charge collection costs, and AEF set to produce a CCSN of £271. This was the only option which resulted in actual community charges below £300 for the range of possible actual expenditure figures considered in the paper.

He considered that option D represented a realistic and defensible settlement. But it would be premature to reach decisions before Ministers had had the chance to consider illustrative figures for the community charges which individual local authorities would need to levy. These would depend on detailed decisions on needs assessments and the transitional safety net, on which work was still in progress. Nevertheless he proposed to bring forward detailed exemplifications to E(LF) before he invited colleagues to take firm decisions on the level of total needs and AEF.

The Chief Secretary, Treasury, said that in deciding the level of total needs and AEF in 1990/91 the Government faced a difficult balance between ensuring acceptable community charges and restraining local authority spending. In the previous year the Government had agreed a generous settlement for 1989/90. It was now clear that the result had been substantially increased expenditure, up 9 per cent in cash terms. The position in Scotland, where the community charge had been introduced in April, was even worse, with expenditure up by 12 per cent. It was important not to repeat the same mistake in relation to England in 1990/91.

He therefore favoured option A in the paper, under which total needs would be set 7.5 per cent above the level of grant-related expenditures (GREs) in 1989/90, and AEF would be increased by 4 per cent, the latest estimate of the deflator. The CCSN under the option would be £264. The increase in total needs, which exceeded the likely rate of inflation, would ensure that many responsible authorities could still spend below their individual needs assessments. But holding AEF constant in real terms would restrain local authorities' spending decisions. He was concerned that any further addition to grant would result in higher expenditure rather than lower community charges.

In discussion the following main points were made:

a. It would certainly be desirable to keep the level of community charges in 1990/91 as low as possible and preferably below £300. Quite apart from political considerations, this could have important indirect benefits, for example on the Retail Prices Index (RPI). It would also be important to ensure that the basis on which the community charge was included in the RPI was technically correct and did not give rise to any overstatement of the index in 1990/91.

b. On the other hand, there would be substantial dangers in trying to restrain the level of the community charge by increasing the level of AEF in 1990/91. Local authorities were likely to take that as a signal that they could increase their spending, as in 1989/90, resulting in higher public expenditure and no reduction in the community charge. The Government might have to accept that the average level of charges in the first year would be on the high side, as local authorities took advantage of the introduction of the new system to push up their spending and rebuild balances. Only in later years would the increased accountability under the new system begin to bite on expenditure.

c. One approach to setting the total need to spend would be to identify how much of the increase in 1989/90 was due to external pressures on local authorities, such as pay settlements for the police and the teachers and the need to prepare for the community charge, and how much was due to their own decisions. That would allow the Government to set needs and grant at realistic and defensible levels. Such an approach was likely to be favoured by the Ministers responsible for the main local authority services.

d. On the other hand such a bottom-up approach to setting total needs would involve unacceptable risks. It would be much better to build on the total of GREs in 1989/90, which reflected a generous estimate of what authorities needed to spend in the current year, and were themselves substantially above GREs for 1988/89. Options A and B started from this base, adding increases of 7.5 per cent and 9.5 per cent respectively. There was no case for going substantially higher than that.

e. A considerable part of the increase in AEF under each of the options in the paper would come from the natural buoyancy of the national non-domestic rate (NNDR). It was right to take this into account in setting the level of needs grant and specific grants, since the alternative would be to provide local authorities with an excessively buoyant source of revenue. Nevertheless this could be controversial, and would require careful presentation. It might for instance be relevant to quote this increase in grant to local authorities over a longer period than one year, for instance taking 1989/90 and 1990/91 together on a 1988/89 base.

f. It would be important to look at exemplifications of the likely effects of the settlement on individual local authorities' community charges. Nevertheless Ministers would want to bear in mind that the pattern of charges could be influenced by decisions on the transitional safety net and on the method of dividing the needs total between local authorities. In this context it would be important not to refer to "needs assessments" for individual local authorities, which would give the impression that the Government was setting a minimum level of spending which was needed in each local authority area. A new and more appropriate term was needed and further consideration should be given to this.

The Prime Minister, summing up the discussion, said that it was clear that the 1990/91 grant settlement would be a sensitive one, and it would be essential to make it on a defensible basis. There were strong arguments for introducing the community charge at a reasonable level, preferably below £300. But it would not be right to seek to achieve this by making a substantial increase in Aggregate Exchequer Finance, which was more likely to result in increased local authority spending than reduced community charges. Nor would it be right to set a total level of needs which validated the substantial increase in local authority expenditure in 1989/90. These considerations ruled out option D in the paper, which was clearly much too generous. On the other hand, option A was probably too tough.

It was therefore agreed that the Secretary of State for the Environment in consultation with the Chief Secretary, Treasury, should bring forward papers for E(LF)on the basis only of options B and C in the present paper. In E(LF) Ministers would wish to look at figures which showed how grant to local authorities and total needs assessments had moved over the period from 1988/89 to 1990/91, and this information should be included in the next paper. It would also be necessary to look at exemplifications of the likely community charge in each local authority area under the various options. The Secretary of State should also consider the term to be used for the individual assessments of local authority spending for grant purposes: it would not be appropriate to refer to "needs assessments" since that would give the impression of a minimum reasonable level of spending set by the Government rather than the maximum which they ought to be.

I am copying this letter to private secretaries to the other Ministers who attended the meeting and to the others present.

Yours,
Paul

PAUL GRAY

Roger Bright, Esq.,
Department of the Environment

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CC: Chancellor
Sir P Middleton
Mr Anson
Mr Monck
Mr Phillips
Mrs Lomax

BF 12/6

Treasury Chambers, Parliament Street, SWIP 3AG

Miss Peirson
Mr MacAuslan
Mr Potter
Mr Edwards
Mr AM White
Mr Hudson

Rt Hon Malcolm Rifkind QC MP
Secretary of State for Scotland
Scottish Office
Dover House
Whitehall
London
SW1A 2AU

31 May 1989

Mr G White
Mrs Chaplin
Mr Call
Miss Wheldon (T.Sol)
Ms Dejager (T.Sol)

Dear Secretary of State,

Community Charge Capping in Scotland

I am grateful for your letter of 18 May and Nick Ridley's letters of 16 and 23 May.

Although I well understand your preference for avoiding charge-capping, I see this as a key strategic issue in relation to the Community Charge policy as a whole.

The fact is that three Scottish local authorities have budgeted to spend between 35 percent and 45 percent above assessed needs and three more at between 27 percent and 30 percent above assessed needs. As you yourself imply, some Scottish authorities have clearly seen introduction of the new system of local government finance as providing an opportunity to step up their spending while blaming the Government.

From a legal point of view, you have confirmed that inaction this year could prejudice action in future years. I see this as a major concern. With respect, I do not think that an announcement that inaction should not be taken as a precedent would solve the problem; and Nicholas Ridley has pointed out the particular disadvantage in making any announcement which could be taken to imply that capping would be inappropriate in the first year of the new system.

I agree of course that we must be alive to the risks of judicial review. We should not, however, in my view, allow that to deter us from acting as the situation demands. Our aim this year (as in previous years) should rather be to minimise the risks by consistency of action, both as between one year and another and as

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between individual authorities, and by punctilious observance of procedures. I note what you say about interpretation of the "excessive and unreasonable" levels of planned expenditure mentioned in the legislation. However, we have successfully rate-capped Scottish authorities in times past or brought them to the negotiating table. I believe we ought also to consider further whether the test of what is an "unreasonable" level of expenditure would have to be as exacting as that mentioned on page 2 of your letter, bearing in mind the criteria which you are required to take into account in reaching your capping decision.

At a political level, we should not in my view allow our bluff to be called by authorities who decide to spend up and blame the resulting burdens on introduction of the Community Charge. As implied in Nick Ridley's earlier letter, that would transmit a most unfortunate signal to local authorities throughout Britain.

As noted in my earlier letter, you are better placed than I to identify the options. Apart from your preferred option of <u>no</u> capping, however, I suspect that the main options may be to cap authorities exceeding their assessed need to spend by (a) 35% or more, (b) 30% or more, or (c) 25% or more. Also for consideration is whether you would really be justified in discounting Glasgow's European "City of Culture" expenditure and whether such treatment would make it difficult, from a political and legal point of view, to defend charge-capping other authorities. Depending on how that issue is resolved, options (a), (b) and (c) would I believe imply capping 2 or 3, 4 or 6 authorities, respectively.

I understand the sensitivity of this for you. But the reality is clear. If we do not cap severe overspenders we will send an appalling signal about our firmness of purpose on local authority spending. Whether we like it or not, we will set a precedent if we overlook this over expenditure. It will be a legal precedent in Scotland and a political precedent throughout the country. We cannot undo the precedent by saying it is not a precedent.

I continue to believe we should cap the worst overspenders and would be grateful for your further consideration. We must clearly resolve the matter urgently as time is running out.

I am copying this letter to the Prime Minister, Nicholas Ridley, Cecil Parkinson, Peter Walker, and Sir Robin Butler.

Yours sincerely
P. Wailess

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