

PREM 19/1082

PART 2

Confidential Filing

The future of the Rating System.

LOCAL GOVERNMENT

Rating Revaluation

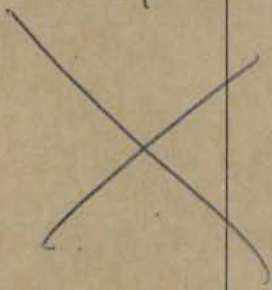
Pt 1 :- May 1979

Pt 2 :- July 1982

| Referred to | Date | Referred to | Date | Referred to | Date | Referred to | Date |
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| 27.7.82 | | 5.5.83 | | | | | |
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~~PART 2 ENDS~~



PART 2 ends:-

SS/Environment to PM 29.6.83

PART 3 begins:-

MCS to Environment 4.7.83

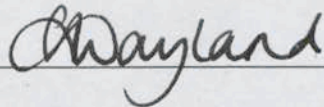
TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

| Reference | Date |
|---|----------|
| MISC 79(82) 13 | 23.07.82 |
| MISC 79(82) 14 | 27.07.82 |
| MISC 79(82) 15 | 27.07.82 |
| MISC 79(82) 5 th Meeting, Minutes | 29.07.82 |
| MISC 79(82) 17 | 08.09.82 |
| MISC 79(82) 19 | 10.09.82 |
| MISC 79(82) 6 th Meeting, Minute 1 | 16.09.82 |
| MISC 79(82) 23 | 24.09.82 |
| MISC 79(82) 7 th Meeting, Minute 3 | 30.09.82 |
| MISC 79(82) 11 th Meeting, Minute 1 | 22.12.82 |
| CC(83) 1 st Meeting, Minute 7 | 20.01.83 |
| E(LF)(83) 2 | 11.02.83 |
| E(LF)(83) 3 | 14.02.83 |
| LCA to E(LF)(83) 1 st Meeting, Minutes | 16.02.83 |
| E(LF)(83) 2 nd Meeting, Minutes | 14.03.83 |
| E(LF)(83) 7 | 21.04.83 |
| E(LF)(83) 9 | 21.04.83 |
| E(LF)(83) 8 | 22.04.83 |
| E(LF)(83) 10 | 22.04.83 |
| LCA to E(LF)(83) 3 rd Meeting, Minutes | 27.04.83 |
| E(LF)(83) 11 | 03.05.83 |
| E(LF)(83) 12 | 03.05.83 |
| E(LF)(83) 4 th Meeting, Minutes | 05.05.83 |
| C(83) 15 | 09.05.83 |
| CC(83) 17 th Conclusions, Minute 3 | 10.05.83 |

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate CAB (CABINET OFFICE) CLASSES

Signed



Date 16 April 2013

PREM Records Team



Prime Minister

Prime Minister

RATE LIMITATION LEGISLATION

Yes. I favour Option B and Model 2. Am very pleased with the way the work is shaping up.

Agree, subject to colleagues,

to this basis for the White Paper?

Or would you prefer to await colleagues' views?

In our Manifesto we promised to "legislate to curb excessive and irresponsible rate increases by high spending Councils, and to provide a general scheme for limitation of rate increases for all local authorities to be used if necessary". We also promised certain reforms to the non-domestic rating system. We have now confirmed in The Queen's Speech that legislation will be introduced this session. The Bill needs to be enacted by the summer of 1984 so that we can take steps to limit the rates of selected authorities for 1985-86. It must therefore be introduced no later than January; which means that we must settle the details of both the selective and general schemes and complete instructions to Counsel by the early autumn.

MCS 1/7

In my speech in the Debate on the Address on 23 June I gave a very general indication of our intentions. I suggest that the next step should be the publication of a White Paper setting out our proposals in more detail. This will also serve as a response to the Second Report of the Environment Committee on the Government's Green Paper "Alternatives to Domestic Rates" (Command 8449). It should therefore include not only our proposals for rate limitation, but also details of the other rating reforms which we propose. I shall be consulting colleagues further on these other reforms, including the two specific topics which the Cabinet invited my predecessor to consider further: reevaluation and a possible discount



scheme (CC (83)17th). Meanwhile this minute sets out the main features of the rate limitation schemes, which I invite you and other colleagues to endorse as the basis for preparing a White Paper.

I attach a detailed paper by DOE officials on how the selective and general schemes might be designed. It has been discussed with other Departments at official level. Paragraph 57 (of which a separate copy is immediately below) summarises the issues for decision. In this minute I draw attention to the most important issues listed in that paragraph.

I THE SELECTIVE SCHEME

Number of authorities to be controlled B(i)

Under the selective scheme we might aim to bring about 15 authorities within control. The main constraints on the numbers brought into control are the nature of the Parliamentary procedure (see paragraph 14 below); and the desirability of keeping numbers down to avoid legal challenge on grounds of inconsistency in decisions, especially as we will be breaking new ground in establishing a control system. I also believe that it will be important in terms of Parliamentary handling to show that the Government is concerned with relatively few high spending authorities under the selective scheme.



Criteria for selection B(ii)

I am sure that we should seek powers to select authorities for control by reference to a very general criterion, such as "excessive expenditure". This will give us maximum freedom of manoeuvre, and allow us to discriminate between authorities that are genuinely trying to comply with Government guidelines and those that are not. In practice we shall want to be able to take account of such matters as a) levels of expenditure (eg in relation to grant related expenditure assessments (GREs)); b) increases in expenditure; and c) increases in rates. And we shall want to be able to adopt different criteria from year to year.

We shall certainly come under pressure to specify the criteria in the main legislation. This would constrain us too much; but I believe that we should be willing to provide in the Bill for a requirement on the Secretary of State to report to Parliament each year, for information, the criteria used for selection. We may ultimately be forced to concede a procedure in which the criteria have to be approved in an annual Order subject to affirmative resolution but I would certainly not want to go that far in the White Paper.

We shall need to consider what arrangements to make for the joint boards created on abolition of the Greater London Council and Metropolitan County Councils. One possibility would be to apply the same criteria for selection to them as to any other authority. But it may well be better to apply a general



control to all the joint boards, at least initially. The control could later be replaced by the normal selective approach. The issue could be left open in the White Paper on rate limitation and reform; but we shall need to make our intentions clear in the autumn White Paper on abolition.

De Minimis Exclusion - B(iv)

I believe that we need powers to exclude authorities whose expenditure is too small to affect the aggregates significantly. If, for example, we were to exclude authorities spending less than £10m a year, this would automatically eliminate 276 of the 296 shire districts. Since the shire districts as a whole account for only about 7% of local authority current expenditure, this would have little or no effect on local government expenditure as a whole. And since the numbers to be controlled in the selective scheme are limited we do not want to displace a high spender, in relation to the Grant Related Expenditure, with a large budget of over say £100m, with a high spender with a budget of less than say £10m. Moreover a firm undertaking to make an exclusion of this kind could be presentationally very helpful, since it could be expected to reduce the hostility of the Association of District Councils. I will further consider the terms of the undertaking in preparing the White Paper.

Rate Reductions - B(vi)

✓ It is important that we take powers to require rate reductions as well as to restrain increases.



Form of Control - B(vii)

There are two possible ways in which the control system could operate. Under Option A - the approach outlined by my predecessor in his paper E(LF)(83)11 - selected authorities would be required to submit their budgets for scrutiny from about July each year. An alternative approach - option B - would involve giving to selected authorities formula based expenditure targets from which it would be for them, if they wished, to seek derogations. (In both cases an expenditure figure determined by the Secretary of State would be the basis for setting rate limits once grant entitlements had been determined in the RSG settlement.)

Colleagues will recall that in previous discussions the Attorney General advised that a system of control which places the onus on a local authority to seek a derogation from the Secretary of State is less susceptible to successful legal challenge. Bearing this in mind, I believe that option B has several advantages over option A:

- i. Scrutiny will be costly and time-consuming. Under option B we would look in detail only at the budgets of those authorities seeking derogations.
- ii. Under option B, authorities would have to give us the facts to justify their applications for derogations, whereas under option A the onus would be on us to seek and obtain the necessary information.



iii. Since under option B it would be for local authorities to provide the relevant facts, there would be a smaller risk of successful legal challenge to the Secretary of State's decisions, on the grounds that he had overlooked particular points.

✓ I favour option B, and suggest that it should be the basis for the description of the scheme in the White Paper. If we continue to have individual expenditure targets for all authorities, this approach will fit in very well with them; but it would also be compatible with a block grant system without targets and holdback.

Balances - B(x)

Once an expenditure limit is agreed (in July or later) and the grant level determined (in December) it will be possible to determine the rate limit. We need to decide whether we wish to be able to take an authority's accumulated balances into account when deriving its rate limit. To do this we should need to examine each authority's accounts in detail and to make judgements on prudent levels of balances. Balances can only be used once and are not large in absolute terms; and we may in due course decide that the effort of taking account of them is not worthwhile. But in my view we should take powers to enable us to take account of balances if we so wish, not least in order to discourage authorities from rating up in 1984-85 before the controls are in place.



Future of Targets - B(xii)

There can be no doubt that we should make the passage of the legislation much easier if in introducing the Bill we were able to promise an end to the system of targets and grant holdback system for authorities in general. But the target system is part of our armoury for restraining local authority aggregate expenditure, and I believe that we shall need to keep targets and holdback for 1984-85 in order to discourage spending up in the last year before the control scheme comes into force. And it is too early to decide about 1985-86. We shall need to keep this issue in mind, however, during the passage of the Bill.

Parliamentary Procedure - B(xiv)

It is clearly right that Parliament should have the power to approve or reject rate level determinations in cases of disagreement between the Secretary of State and the local authority. I would judge the best vehicle to be Orders laid before both Houses, but subject to affirmative resolution only ✓
 ✓ in the House of Commons, as under the present Scottish arrangements. There is a further choice between individual Orders for each authority (as under the Scottish arrangements), or composite Orders covering a number of authorities. It might be that individual Orders would create further pressure on Parliamentary time and further work, thus limiting the number of authorities that could be controlled. I should welcome the



Chief Whip's advice on whether composite Orders would be preferable in terms of use of Parliamentary time. My own present preference is for composite Orders, on the grounds that they would - at least in principle - allow the possibility of controlling a larger number of authorities.

Interim Rates - B(xv)

It will not always be possible to set an authority's rate limit before the start of the rating year. We shall therefore need a power for an authority to set first an interim rate, and subsequently a final rate. We must avoid calling the latter a "supplementary rate", following the abolition of authorities' powers to levy such rates last year. We must also leave open the option of allowing temporary borrowing instead of an additional rate in appropriate cases.

Advice from Other Departments and Agencies - B(xvi)

It will be very important to ensure that DOE, other Government Departments concerned, and agencies such as the MSC, HSE and National Health Service avoid encouraging authorities through circulars or subordinate legislation to spend money in ways inconsistent with the control scheme. Arrangements will have to take account of the fact that different Departments in England have a formal statutory role in respect of different services.



II THE GENERAL SCHEME

Form of Control - C(ii)

I have considered two alternative models for the general scheme. Under the first (model 1) we would set standard limits on rate increases for each class of authority, without considering the expenditure levels and needs of individual authorities. Each authority's permitted expenditure would then be derived from its rate limit and its grant entitlement; and the pattern of permitted increases would be irregular. Under the second (model 2) we would in July set appropriate expenditure levels for all authorities (as under the selective scheme), which would then be translated into rate limits after the RSG settlement. Under model 2 rate increases would be controlled indirectly, and their pattern would be more irregular than under model 1.

Model 1 looks presentationally simple and attractive, and controls rate increases directly. But I believe that politically it would be difficult to defend because it takes no account of individual authorities' circumstances; for that reason we should get a very large number of applications for derogations, and would have great difficulty in handling them without incurring legal challenge. Model 2, using individual expenditure levels, would be more readily defended and should produce fewer applications for derogations. It would also follow on more naturally than model 1 from option B of the selective scheme since under both the Secretary of State would set explicit expenditure figures for each authority controlled. The transition from the selective to the



general scheme, if it ever occurred, would thus be easier. Moreover model 2 would do as well as, if not better than, model 1 in controlling aggregate expenditure since rate increases and grant would both be controlled under either model; and we should probably be able to concede fewer derogations under model 2. For all these reasons, but especially sensitivity to individual authorities' circumstances, I favour model 2, and I propose that the White Paper should be drafted accordingly.

We shall of course come under great pressure to be specific about the circumstances that would trigger the transition from the selective to the general scheme. We cannot be specific; the judgment that would have to be made would be a complex political one (and different considerations might apply in England, Scotland and Wales). Our supporters who are sympathetic to local authority interests are more likely to be hostile to the general scheme than the selective one, and so we shall have to stress the reserve nature of the general powers.

There would be many more applications for derogations under the general scheme than the selective one, because it will apply to all authorities. The workload problem could become acute, and it would be necessary to seek so far as possible to develop standard criteria for the granting of derogations. It would also be desirable to provide for a de minimis exemption, as under the selective scheme. It would be necessary, under either model 1 or model 2, to ensure that achievable limits are set in order to avoid legal challenge. This also points to the need for allowing some headroom in the limits set.



Parliamentary Procedure - C(vii)

I am clear that rate limits should be approved by a single Order, without the need for further reference to Parliament of agreed derogations.

III DEFAULT AND OBSTRUCTION

The possibility of default and/or obstruction has to be considered in the context both of rate limitation and of local government restructuring. There is a difficult judgment to make - in both cases - as to whether explicit provisions in respect of default (including a power for Commissioners to take over running of some or all services) would be provocative and counter-productive; or would show that the Government means business. There are various legislative opportunities, including the rate limitation Bill itself this session, or a possible separate Bill in the 1984-85 session if it became clear then that legislation were needed. We cannot take a firm view until the pattern of reaction to our proposals becomes clearer, and a final decision is not needed in the context of the White Paper, which does not have to go into details on this subject. But in the meanwhile I have put contingency work in hand with the aim of having Instructions to Counsel ready by October in cases our decision at that stage is to go ahead with legislation this session in either or both contexts.



IV NEXT STEPS

I should be grateful for your agreement that work should proceed on the basis outlined in this minute. Subject to your views and those of colleagues I would then propose to circulate a draft White Paper early next month.

I am copying this minute to Cabinet colleagues, the Attorney-General, the Chief Whip and to Sir Robert Armstrong.

PJ

P J

29 June 1983

V SUMMARY OF ISSUES FOR DECISION

57. The following is the list of issues for decision identified in this paper. Officials recommendations are incorporated.

A. Scope for legislation

(i) The legislation should apply to England and Wales; Scotland will have its own Bill (paragraph 5);

(ii) Rates control in England and Wales should be operated separately by the territorial Secretaries of State (paragraph 5).

B. Selective control

(i) No more than about 15 authorities should be selected for control at any one time. (NB. Transitional problems with joint boards following abolition of GLC and MCCs) (paragraph 9);

(ii) The criteria for selection should only be delineated in the Bill by a general reference, for example to "excessive expenditure" (paragraph 10).

(iii) The selection of authorities should be determined according to principles applying to all authorities in a particular class and not subject to specific Parliamentary scrutiny (paragraph 11).

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(iv) The Bill should include a power to exclude authorities whose expenditure is below a minimum level. A limit of £10m would exclude all but 20 shire districts (paragraph 12).

(v) The expenditure and precepts of minor authorities (parishes and others) should not be controlled individually, but should count against the expenditure and rate limit of the rating authority (paragraph 13).

(vi) The Bill should provide for the Secretary of State to require rate reductions, as well as to restrain rate increases (paragraph 15).

(vii) Ministers should express a preference on the form of operation of selective control as between Options A and B (paragraphs 17-21);

- Option A Authorities rate limits set on the basis of expenditure figures approved after detailed scrutiny of draft budgets sent in October by all selected authorities.

- Option B Authorities rate limits set on the basis of formula expenditure targets set in July as amended on derogations from authorities unable to manage within target.

Officials recommend Option B because it would reduce the risk of legal challenge and be much simpler administratively.

(viii) The Bill should provide for a power to attach conditions to the determination of a rate (paragraph 23).

(ix) There should be no specific statutory role for management consultants in negotiations about rate levels (paragraph 24).

(x) Approved expenditure can be translated into maximum rate limits on the basis of a formula or, after taking into account the balances held by authorities (paragraphs 26-29). Ministers are asked to express a preference.

(xi) The Secretary of State should take powers to require the provision of information and to make assumptions, which would not be legally challengeable, if authorities failed to co-operate (paragraph 30).

(xi.a) Scrutiny of authorities' budgets may require the Secretary of State to have regard to rents and fares. The implications of legislation on Protected Expenditure Levels (PELs) and rents will need to be investigated (paragraph 22).

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Relationship with expenditure targets

(xii) Decisions on the future of targets in the context of selective control need not be taken until 1984; until then Ministers need say publicly only that the relationship with the control scheme is being considered (paragraph 34).

Parliamentary procedure

(xiii) Where agreement is reached between the Secretary of State and the local authority on expenditure and rate levels, rate limits should be set by direction or Order by the Secretary of State without reference to Parliament (paragraph 35).

(xiv) Where there is disagreement about expenditure levels, or agreement about expenditure but not about rate levels, those rate levels should be set by an Order subject to affirmative resolution. Such an Order should preferably be capable of covering several authorities at a time (paragraph 35 and 36).

(xv) Authorities should have power to set an interim rate where agreement has not been reached before the normal date for setting a rate; and power subsequently to levy a larger final rate if a limit higher than the interim is eventually agreed, or to approve temporary borrowing in appropriate cases (paragraph 35)".

(xvi) Arrangements in Government should be made to ensure that Departmental circulars and subordinate legislation do not impose financial burdens on authorities inconsistent with the control scheme (paragraph 27).

C. General control scheme

(i) A transfer from selective to general control should be effected by statutory instruments subject to affirmative resolution (paragraph 40).

(ii) Legislation should be prepared on the basis of either Model 1 or Model 2, described in paragraphs 38-47.

- Model 1 Standard rate increases determined by the Secretary of State - subject to adjustments to base line rates. Authorities' permitted expenditure determined in December each year by combination of rate income and grant entitlement. Applications for derogations dealt with after RSG Settlement.

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- Model 2 Authorities set reasonable expenditure levels in July - applications for derogation made from late summer onwards. After RSG settlement approved expenditure translated into permitted rate levels for each authority sufficient to finance approved expenditure.

Officials recommend Model 2.

(iii) The Secretary of State should have power to attach conditions to derogations granted (paragraph 48(i)).

(iv) One such condition might be to require a review by consultants of particular aspects of an authority's services (paragraph 48(ii)).

(v) Power should be taken to allow the Secretary of State to take into account authorities' balances (paragraph 48(iii)).

(vi) Grant holdback would be superfluous under a general scheme (paragraph 48(iv)).

(vii) Parliament would approve rate levels for all authorities in a single order. Derogations from the general limits could be granted by the Secretary of State without further reference to Parliament (paragraph 48(v)).

(viii) As in the selective control scheme, there should be a power to set interim rates and allow higher or lower final rates and approve temporary borrowing where appropriate (paragraph 48(vi)).

(ix) Small authorities should be excluded from general control (paragraphs 48(vii)).

(x) Further consideration of whether parish precepts should count against the expenditure and rate limit of the rating authority, and a submission will be made in due course.

(xi) Authorities' income from fees, rents, fares and charges should be allowed to remain as safety valves, as officials recommend (paragraph 48(x)).

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1. Default and intervention

(i) Whether to prepare legislation in anticipation that authorities resisting control may default from their obligations; by providing for the appointment of Commissioners (paragraph 52).

(ii) Whether to legislate in the main Control Bill; in a separate Bill in the 1984/85 Session; or to be ready to legislate in the light of authorities' response to control (paragraphs 52-54).

CONTROL OF RATES

I INTRODUCTION

1. The Cabinet agreed on 10 May that the Government would now cease the search for alternative local taxes to replace rates and legislate in 1983/84 for a scheme to control the rates of selected high spending authorities from 1985/86; and also for a more general scheme of rate control, to be introduced if the selective scheme did not produce the desired results. A commitment to this effect was included in the Conservative Party Manifesto.

The timing of supporting legislation on obstruction and default is for decision.

2. This submission discusses the next main steps (paras 3-8). The rest of the submission is organised as follows:

| | |
|--------------------------------|-------------------------------------|
| Part II (paragraphs 8 to 37) | Selective Control Scheme |
| Part III (paragraphs 38 to 48) | General Control Scheme |
| Part IV (paragraphs 49 to 56) | Default and Intervention |
| Part V (paragraph 57) | Summary of Issues for Decision |
| Annex 1 | Summary of Block Grant Arrangements |
| Annex 2 | Criteria for Selection |
| Annex 3 | Timetables for Selective Control |

Background

3. Ministers of the previous Administration had not decided on the detail of either the selective control scheme or the scheme of general control. Two substantial rating reform issues also remained undecided (a) whether to allow discounts from the rate bills for certain categories of householder; and (b) the basis on which domestic property should be valued.) Moreover the previous Government had not replied to the Second Report of the Environment Committee: "Enquiry into methods of financing local government in the context of the Government's Green Paper (Cmnd 8449)". This was published in September 1982 and followed a period of public consultation on the Government's Green Paper "Alternatives to Domestic Rates" which had been published in December 1981.

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4. This submission sets out the issues which Ministers will have to decide. Some of the issues can be finally decided a little later in the course of preparing the White Paper. Full submissions on these issues will be made in due course, but they are explained here in some detail so that Ministers can see clearly the choices they will have to make.

5. There is already Scottish legislation providing for a selective, but not a general, scheme of rate control. Scottish officials believe that their Secretary of State may prefer to have completely separate Scottish legislation on rate control and rating reform. This submission is based on that assumption. The Bill for England would, however, apply also to Wales. Rate control there would be operated by the Secretary of State for Wales.

6. In taking their decisions immediately before the Election was called Ministers had before them a report by officials (the "RP Report") which, in response to the remit previously given by Ministers meeting in the Local Government Finance Sub-Committee of the Economic Strategy committee (E(LF)),

- a) set out options for a general scheme of rate control; and
- b) discussed longer term options for supplementary or alternative local taxes.

Now that Ministers have decided that rates are to remain as the sole local tax, (b) is no longer relevant. The first part of the report, however, on options for a general control scheme, remains relevant, and is the basis for part III of this submission. The report did not discuss options for a selective control scheme, since this was not part of the remit given to officials. No detailed work had been done on selective controls since an earlier discussion by Ministers meeting in MISC79 during the summer of 1982.

7. Ministers may find it helpful in considering both the selective and general control schemes to refer to the descriptions of the existing grant, target and holdback arrangements in Annex 1.

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II SELECTIVE CONTROL SCHEME

8. This section considers under the following headings the main issues for decision on the selective system of control.

- (i) Criteria for selecting high spending authorities
- (ii) Procedure for setting the rate limit
- (iii) Relationship with existing expenditure targets
- (iv) Parliamentary procedures.

(i) Criteria for selecting high spending authorities

9. In previous discussions between Ministers it has been generally assumed that a selective scheme would be operated so as to catch about 15* authorities each year. This is consistent with the Manifesto commitment to control the rates of "high spending" authorities. But there is no simple or uncontentious definition of what "high spending" means. Annex 2 discusses some options, and shows the authorities which are the highest spenders on different criteria, including

- (i) percentage overspend on expenditure target (as used for determining grant holdback);
- (ii) percentage overspend on grant related expenditure assessment (GRE);
- (iii) per capita overspend on GRE;
- (iv) cash overspend on target.

These criteria could be used either singly or in combination.

Other options are possible including in particular expenditure increases over two or more years. It is of course possible to combine some criteria eg on absolute spending levels and relative changes in spending.

10. If Ministers wish to have maximum discretion in selecting authorities for control, the main legislation should specify the criteria for selection in general terms. The present Scottish legislation allows selection of authorities whose expenditure is "excessive and unreasonable".

* On abolition of the GLC and MCCs arrangements should be made to bring the 40 separate joint boards proposed within the control scheme, at least initially.

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The precise form of words to be used in the English legislation will need further consideration with lawyers in the preparation of the Bill. A full submission will be made later. For the time being Ministers are invited to agree that a simple general formula only should be incorporated in the legislation and that public references to the objectives of the control scheme should refer to an intention to select authorities whose expenditure is excessive.

11. Parliament will no doubt expect the Secretary of State to act equitably and consistently in selecting authorities for control, and it may be necessary to provide in the legislation for his discretion to be constrained accordingly. Possible constraints - in ascending order of severity - include:

- (i) an explicit requirement for the Secretary of State to act "in accordance with principles applicable to all authorities or all authorities in the appropriate class" (Provisions of this kind already constrain him in setting expenditure targets and determining block grant under existing legislation);
- (ii) a requirement to report to Parliament each year - for information rather than approval - the criteria used for selection;
- (iii) a requirement to set out the criteria in an annual Order subject to affirmative resolution.

Officials' preliminary views are in favour of option (i).

A de minimis exclusion

12. A requirement to act on principles applying to all authorities would allow Ministers to exclude from the possibility of selection authorities with budgets below a de minimis level. Spending by such authorities does not seriously affect the Government's expenditure plans. But unless excluded, some such authorities fall within the criteria for control because their expenditure is often very variable between years. A limit of £10m expenditure per annum would exclude all but the 20 largest shire districts and the Isles of Scilly. Their exclusion would

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considerably simplify the operation of either a selective or a general control scheme. For this reason officials recommend a separate explicit power to exclude groups of authorities.

13. Parish councils and other lower tier precepting bodies would anyway need to be excluded from independent scrutiny. But, where relevant, their expenditure would be included in the control totals of the rating authorities potentially subject to scrutiny. Where the numbers in control are small any problems can be dealt with by consideration of local circumstances. It would not be worth considering any more fundamental solutions.

(ii) Procedure for Setting Rate Limits

14. The appropriate rate for an authority will depend on

- a) an approved level of expenditure - which will have to take account of likely income from fees rents and charges.
- b) its grant entitlement.
- c) the availability of funds held in balances or special funds from the previous year.

15. Rate limits for a future year cannot be set until after the Rate Support Grant settlement in the preceding December which fixes authorities' grant entitlements. Authorities will need much earlier notice if they are to achieve necessary expenditure reductions. Therefore the control scheme will have to operate by first approving expenditure levels and, subsequently, controlling rates to a consistent level. There could be disagreements with authorities at both stages of this procedure. The power to determine rate levels should encompass a power to require rate reductions compared with the previous year.

16. The Scottish system of selective control operates only after rates have been set, and allows the Secretary of State both to withdraw grant and to require a rate reduction. In earlier discussion Ministers did not favour a simple adaptation of the Scottish system for England and Wales, since intervention by the Secretary of State would come too late to be effective.

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Determining an approved level of expenditure

17. The annual timetable of two alternative procedures for setting an approved level of expenditure are set out in detail in Annex 3.

18. Under Option A, authorities would be selected for possible rate control between April and July of the preceding year. Those selected would be required to submit draft budgets to the Secretary of State by the autumn and the draft budgets would be subjected to detailed scrutiny by the DOE, in consultation with the other Departments responsible for local government services. In the light of that scrutiny, which would take account of such sources of income as rents, fees and charges, the Secretary of State would determine an approved level of net expenditure. This approach was originally described by Mr Heseltine in the discussions in MISC 79 in 1982, and by Mr King in his paper E(LF)(83)7. It was outlined in comments made by Mr King during the Election campaign.

19. Ministers have recognised that this approach has some major disadvantages. In particular:

- (i) Detailed scrutiny of this sort would make heavy demands on the resources of the Department. It would involve complex negotiations with individual authorities, many of which would be unwilling to co-operate, and with other Government Departments, which have an interest in protecting the local government services for which they are responsible.
- (ii) There would be a substantial risk of legal challenge to the decisions of the Secretary of State. It would be his responsibility to ensure that he had taken account of all relevant considerations. This would be particularly difficult where authorities declined to submit information requested of them or even failed to volunteer information which they could later argue to be relevant.

20. Under Option B, the authorities selected for control would each be given a target expenditure figure, based on a general formula rather than on the scrutiny of draft budgets. Any authority which was unwilling to accept the target

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expenditure figure would be able to seek a derogation from the Secretary of State, submitting whatever material they thought appropriate in support of their application. This approach would have several advantages, as compared with Option A:

- (i) A formula figure could be set earlier in the year, perhaps in July. The formula could be related to - or perhaps identical with - the formula used for setting expenditure targets for all authorities as a basis for grant holdback (if such targets are retained - see paragraphs 31 to 34 below).
- (ii) It would be the responsibility of the authority to show that it could not comply with the formula figure and produce relevant information rather than that of the Secretary of State to show that it could. This would reduce the risk of legal challenge.
- (iii) It would not be necessary to scrutinize all the details of an authority's budget unless it applied for a derogation and then only such details as the authority provided to support their case.

21. It would be difficult to draft the legislation in general terms, so as to allow Ministers to adopt either option in any year. Parliament may anyway be reluctant to agree to powers in such general terms. It would be helpful if Ministers could express an early preference as a basis for work on the White Paper and the Bill. Officials recommend Option B.

22. Both detailed scrutiny under Option A and consideration of applications for derogation under Option B, may require the Secretary of State to have regard to the levels of fees, rents and charges in an authority's income. In relation to rents the scope for increases varies from authority to authority and is ultimately constrained by the requirement that rents must be reasonable and that authorities must be seen to be exercising their own local discretion in setting them. Regard must also be had to any statements about spending levels made by other Ministers. The Protected Expenditure Levels (PELs) determined by the Secretary of State for Transport under the Transport Act 1983 has major implications for the levels of local authority fares. We will consult with the Department of Transport to see whether the PEL system will pose special difficulties for rate control.

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Conditions

23. In determining a rate level Ministers may find it helpful to attach conditions requiring authorities to put in hand longer term programmes to reduce expenditure. Authorities would be required to report to the Secretary of State on progress in achieving conditions. Failure to comply could be alternative grounds for selecting an authority for a further year's rate control even if their expenditure levels did not otherwise meet the criteria for selection.

Use of management consultants

24. It was suggested in earlier Ministerial discussions that management consultants might be used to advise the Secretary of State on the appropriate level of expenditure for an authority subject to selective control.

Officials consider that

there are arguments against using management consultants in this way:

- (i) They are unlikely to be able to help where the issues are essentially matters of political choice (eg about the appropriate level of service).
- (ii) There could be a problem for the consultants of conflicting responsibilities to the local authority and to the Secretary of State.
- (iii) Firms might be reluctant to involve themselves in a potential legal dispute between the Secretary of State and the authority or to prejudice their commercial relationships with local government.

25. As an alternative approach, the Secretary of State might make it a condition of approving an expenditure or rate figure that the authority should commission an independent examination of a specified aspect or aspects of its services.

Translating the approved level of expenditure into a rate limit

26. Once an approved expenditure figure has been set, an equivalent rate poundage figure can be calculated in the light of the RSG settlement. There are two options:

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- a) a purely formulaic calculation, using the "grant related poundage" in the case of authorities receiving block grant, and the estimated product of a penny rate for those not receiving grant; or
- b) an individual calculation for each authority, taking account in particular of the funds available to it in balances from the previous year.

(a) is simple but inflexible; (b) allows for greater equity, but requires a more detailed examination of each authority's financial position.

27. The use of balances can significantly alter the rate actually charged by an authority compared with the grant related poundage level derived from the grant arrangements. In order

to avoid determining excessively high rates and allowing balances to be diverted into excess expenditure it would be necessary to take a power to have regard to levels of balances in setting rates. Such a power would be particularly advantageous in the first year of the scheme to deter authorities from rating for substantial additions to balances in 1984/85 before the controls are in place.

28. However, by introducing a separate set of judgements about the contribution which could be made from balances, Ministers would be compelled to consider any representations about those judgements - after they had completed negotiations about expenditure levels.

29. Ministers may wish to bear in mind that in any case the relationship between an authority's expenditure and its rate in any two successive years is not simple; and that even a small increase in expenditure may require a larger increase in the rate. This could happen if either (a) an authority used balances in Year 1 to reduce or keep down its rate and was unable to do so in Year 2; or (b) an authority lost a large amount of grant in the RSG settlement.

Requirement to Supply Information

30. At all stages of the control scheme the Secretary of State will need to be able to seek and require relevant information from the authority about its expenditure and possibly its balances. There are 2 approaches to enforcement:

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- i) the duty to supply information could be placed on the officers of the authority rather than the authority itself. There are considerable problems in devising sanctions to support such an approach. A chief officer could be faced with industrial action by his subordinates or the authority could apply extreme pressure on him as their employee;
- ii) the Secretary of State could arm himself with a power to make assumptions where information was withheld (in the way the Inland Revenue now do). Any such assumption would have to be protected statutorily from challenge in the Courts.

(iii) Relationship with Existing Expenditure Targets

31. A separate submission is being made on the options for expenditure targets and consequent grant holdback in the 1984/85 RSG settlement. Ministers will also need to consider whether targets and holdback should be retained in 1985/86 and later years, when their function of influencing local government expenditure will be partly superseded by the direct control of the expenditure and rates of selected authorities. This submission outlines the main issues for discussion.

32. It has been a feature of the expenditure target system operated in 1981/82, 1982/83, and 1983/84 that the targets have implied large expenditure reductions for high spending authorities - perhaps larger in some cases than an authority could actually achieve within the year. If targets continue to be set on this basis, the addition of a system of selective control could produce anomalies. For example, assume that a group of high spending authorities are all set an expenditure target of 100, and that one of them is selected for direct control. It may then be found, either on scrutiny of that authority's budget (under Option A above), or on consideration of an application by it for derogation (under Option B), that it cannot reasonably be required to reduce its expenditure to less than 105. The result would be that the non-selected authorities would continue to have a non-binding target of 100, while the selected authority had a binding target of 105. This might appear anomalous.

33. It would also be necessary to decide whether controlled authorities should be subject to grant holdback and the consequent higher rates. This problem presents a dilemma. For if the selected authority in the previous example is allowed to spend

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at 105 but is subject to holdback in respect of expenditure between 100 and 105, it will seem that it is being penalized for expenditure which the Secretary of State has accepted as unavoidable. If, on the other hand, it is exempted from holdback, its ratepayers will benefit from lower rates than those of uncontrolled authorities spending at the same relative level; this would be likely to provoke criticism from ratepayers in such uncontrolled authorities.

34. These problems may either be accepted on the terms that targets and holdback are necessary to constrain expenditure generally, in conjunction with the selective control scheme, or avoided by abandoning targets and holdback. Ministers would need to consider the implications of the latter course on those authorities, the majority, not subject to selective control. It is a difficult judgement whether the threat of a general control scheme without targets and holdback would sufficiently deter expenditure increases. On the contrary, it could encourage spending up to establish better expenditure and rate bases for authorities in anticipation of general control. This itself could increase the risk that general control will have to be introduced. Decisions on targets for 1985/86 need not be taken for another year. In the meantime Ministers can say that they are considering their future in the light of the control arrangements. Abandoning targets does not require legislation.

(iv) Parliamentary Procedures

35. The two stage procedure for setting the rate limit (determination of an approved level of expenditure, followed by calculation of a corresponding rate limit) may or may not end in an agreement between the authority and the Secretary of State on appropriate expenditure and rate levels. Where there is agreement, it would seem appropriate for the Secretary of State to determine the rate limit by direction or order but without any need for Parliamentary approval. In the case of disagreement, however, more complex arrangements will probably be needed, including:

- a) a power to set an interim rate limit where it seems likely that further discussion may resolve disagreements but the new financial year is imminent (with the proviso that authorities will be able to make a supplementary rate, with the Secretary of State's approval, in cases where discussions eventually lead to agreement on a higher rate limit); and

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- b) a power to make a report to Parliament proposing a rate limit which would become binding on approval by the House of Commons.

36. It is assumed that Parliament would insist on having the power to approve or reject the Secretary of State's proposed determinations in cases of disagreement, as it already has under the Scottish system of selective control. Ministers will need to consider whether to propose separate orders for each authority or composite orders incorporating the rate limits for a number of authorities. The choice is between the administrative convenience of composite orders and the sensitivities of the House. Ministers may like to take the views of the Chief Whip on whether composite orders would be acceptable. The Joint Committee on Statutory Instruments objected to a composite Scottish order of this sort, although the grounds for doing so were said to be that the Scottish legislation did not give express authority for a composite order. If separate orders are to be required this is likely to limit further the number of authorities which can be controlled. For this reason officials favour composite orders.

Consistency with Central Government

37. Ministers will wish to consider the establishment of machinery within central government to ensure that new circulars and subordinate legislation presented by all central departments, and relevant quangos, does not contain advice or commitments on expenditure which would be inconsistent with the Government's strategic policies for holding down local expenditure and perhaps be used in support of a legal challenge to selective control.

III GENERAL CONTROL SCHEME

38. The powers for a scheme of general control will only be exercised if the selective control scheme does not produce the desired results. The first point at which it will be possible to take a view on this will be in May 1985 on the basis of expenditure and rates for 1985/86. A general control scheme could be introduced for 1986/87. It is assumed that Parliament would expect to approve the transfer from selective to general control, presumably effected by an order subject to affirmative resolution. Ministers will need to decide whether that will require approval by both Houses of Parliament or just the Commons. There should be a power to make the transition separately in England and Wales.

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39. Alternative schemes of general control were extensively considered in Part III of the RP report, but were not discussed in detail by Ministers. The earlier report will form the basis of detailed submissions to Ministers later. Meanwhile this section of the submission outlines the main options. Ministers will need to decide which scheme they favour, before Instructions to Counsel are prepared.

40. If Ministers favour a selective control scheme of the kind described in Part II above, the present RSG system, which compensates ("equalizes") authorities for differences in their needs and rateable resources, can be retained in much like its present form. It is assumed that if Ministers ever wished to move from a selective to a general scheme of control they would still wish to retain the RSG system. (A more radical option, described in the RP report, in which RSG no longer equalized for differences in needs and resources but became a simple deficit grant bridging the gap between an approved expenditure level and the income from an approved rate limit, could not be legislated for in the time available.)

41. The RP report (para 140) listed a number of issues on general control schemes on which Ministers would have to take a view in due course. One is of particular significance. In order to limit the numbers of applications for derogation, PES plans should be brought fully into line with what local government could reasonably be expected to need in the first year of control (ie allowed to increase more than the Government would normally allow).

42. On the assumption that the RSG system is retained, there are two main models for a general scheme of rate control: a "uniform rate increase" model (Model 1) and an "individual rate increase" model (Model 2).

43. Under Model 1 the Secretary of State would set a maximum increase in rates for all authorities or, more probably, for all authorities in the same class (ie, there would be different permitted increases for shire counties, shire districts, London boroughs etc, since each class has different groups of functions and different average rate levels). Each authority's permitted expenditure would then depend a) on its rate limit and b) on its grant entitlement.

44. Under Model 2 the Secretary of State would set for each authority a "reasonable expenditure level", probably using a general formula as in the setting of the present expenditure targets. The maximum rate would then be that needed to

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finance expenditure at the reasonable level so determined, after taking account of the grant entitlement determined in the RSG settlement (and possibly the availability of balances).

45. Thus Model 1 would operate directly on rates, leaving permitted expenditure to be determined as a residual; while Model 2 would operate directly on expenditure, leaving rates to be determined as a residual. In both cases the Government would be able to limit the aggregate of rate increases in any year.

46. In both cases individual authorities would be free to seek derogations from the rate limits or expenditure levels set by the Secretary of State. Applications for derogations will have to be fully and carefully considered, and there will be a risk of legal challenge to the decisions that the Secretary of State takes on them.

47. The main differences between the two models are as follows:

(i) Model 1 might produce a more uniform pattern of rate increases between different authorities - a feature of the scheme which might be particularly attractive to ratepayers. The pattern of expenditure increases would be more uneven, however. Successful derogations, adjustments to baselines to reflect changed responsibilities following boundary changes and reorganisation in the Metropolitan Counties and London, and the effects of abandoning grant holdback would all prevent a uniform pattern of rate increases emerging in practice, particularly in the early years.

(ii) Model 2, on the other hand, would allow a more uniform pattern of increase in expenditure (apart from any skewing away from high spenders) and for that reason might be easier to operate and less strongly opposed by local government. The pattern of rate increases would be more irregular, reflecting in part the degree of change in grant entitlements in each years RSG settlement.

(iii) Since Model 2 operates directly on expenditure it would probably be a better means of restraining local government expenditure as a whole.

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- (iv) Under Model 1 the permitted rate increases could be announced in say July, but authorities would be unable to calculate the implications for their expenditure until after the RSG settlement in, say, December. Under Model 2 authorities would be given 'reasonable expenditure' figures in July and could start the budget cycle in the light of them. Thus under Model 1, applications for derogations could not be made before about January. Under Model 2 applications could be made as soon as authorities' planning cycles had reached a sufficiently advanced stage - from the late summer onwards.
- (v) Model 1 would be more likely to lead to successful applications for derogations since it could not make any specific allowance for authorities' reasonable expenditure needs. It would also be more vulnerable to legal challenge, since the permitted expenditure levels would not be based on formulae of general application.
- (vi) Model 2 would be more similar in form than Model 1 to the selective control scheme, in that both would start from figures of reasonable expenditure. The transition from a selective to a general scheme would thus be easier if Model 2 were adopted for the general scheme.

48. The detailed issues discussed in relation to selective control arise also on the general control scheme. In general there is no reason for Ministers to take a different view on these issues as between the two schemes.

- (i) Power to attach Conditions Granting of a derogation should be subject to a power to attach conditions. The sanction for failure to meet conditions could no longer be the threat of remaining in selective control but would have to be, by implication, a threat to take a less compromising line on future derogations.
- (ii) Use of Consultants A review by consultants might be an optional condition to attach to a derogation.
- (iii) Balances Ministers would have to decide whether to take account of past use or the present availability of balances in setting rate levels

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or granting derogations. To make individual assumptions about balances for authorities in a general control scheme would be much more difficult than in a selective scheme.

- (iv) Grant Holdback Grant holdback under a general control scheme would be superfluous.
- (v) Parliamentary Procedure Rate increase limits (Model 1) or reasonable budget figures (Model 2) would be set by Parliamentary order. The Secretary of State would be able to grant derogations to soften the general limits without further reference to Parliament.
- (vi) Interim Rates There will need to be a power to set interim rates where negotiations about rate levels run into the financial year. There will have to be a consequent power to make supplementary rates.
- (vii) De Minimis Exclusion The value of applications for derogation would be more manageable if all authorities with expenditure below a deminimis level (say £7.5m - £10m pa) could be excluded.
- (viii) Lower Tier Precepts Parish precepts could be counted against the expenditure and rate limit of the rating authority. With the larger number of authorities potentially involved, however, Ministers may like to commission some further work on alternative approaches.
- (ix) Power to Require Information An identical power and sanction would be required as for the selective scheme.
- (x) Authorities' incomes from fees, rents, fares and charges should be left as safety valves for authorities to influence their net expenditure. Authorities' incomes from fees, rents, fares and charges should be left as safety valves for authorities to influence their net expenditure.
- (xi) Central monitoring of advice should be established within central government and agencies to avoid excessive financial demands on local authorities.

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IV DEFAULT AND INTERVENTION

49. Some authorities may refuse to co-operate in or actively seek to obstruct the operation of the control system (whether selective or general). Those bent on confrontation with the Government might spend until they ran out of cash to fulfil statutory duties and meet contractual commitments.

40. This issue was considered in the RP report, which concluded (para 94) that "in cases of determined challenge through default, the Government would have to be ready, and have available the necessary powers, to appoint a Commissioner to run all the authority's functions and meet its statutory obligations". It went on to say that "a Commissioner in these circumstances would undoubtedly have a formidable task. Even if authorities defaulted on a very limited scale, there would be significant implications for central government departments both in terms of manpower numbers and staff costs, particularly for DOE".

51. The discussion in the RP report was in the context of a general control scheme, but it is equally relevant to a scheme of selective control.

52. Ministers will need to consider whether to provide from the outset for powers of direct intervention, or whether to wait for the local authorities' response before deciding whether to take such powers. If they wished to make provision at the outset, the rating legislation might include provisions which either a) set out the detailed machinery for default action or b) allowed the Secretary of State to specify default arrangements in an Order subject to affirmative resolution of the House of Commons. There might however be Parliamentary objection to an order making power on such a major issue.

53. There are two objections to including default provisions in the main Bill:

- a) By being seen to anticipate obstruction the Government might provoke it.
- b) No detailed work has yet been done on the details of default provisions. In order to be effective the legislation would probably need to be complex, and there is little time to work out a comprehensive scheme and have instructions to Counsel ready by October.

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54. A possible compromise would be to deal with default legislation in a separate Bill introduced at the beginning of the 1984/85 Session, for enactment by March 1985, just before the control system would start.

55. There has been some press speculation that some authorities might adopt obstructive tactics which fall short of default. A fuller submission on the question of obstruction which arises also in the context of the abolition of the GLC/MCC's is being prepared.

56. The draft initial statement says nothing about default and intervention. Ministers may wish to give guarded answers in reply to questions on the subject.

V SUMMARY OF ISSUES FOR DECISION

57. The following is the list of issues for decision identified in this paper. Officials recommendations are incorporated.

A. Scope for legislation

(i) The legislation should apply to England and Wales; Scotland will have its own Bill (paragraph 5);

(ii) Rates control in England and Wales should be operated separately by the territorial Secretaries of State (paragraph 5).

B. Selective control

(i) No more than about 15 authorities should be selected for control at any one time. (NB. Transitional problems with joint boards following abolition of GLC and MCCs) (paragraph 9);

(ii) The criteria for selection should only be delineated in the Bill by a general reference, for example to "excessive expenditure" (paragraph 10).

(iii) The selection of authorities should be determined according to principles applying to all authorities in a particular class and not subject to specific Parliamentary scrutiny (paragraph 11).

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(iv) The Bill should include a power to exclude authorities whose expenditure is below a minimum level. A limit of £10m would exclude all but 20 shire districts (paragraph 12).

(v) The expenditure and precepts of minor authorities (parishes and others) should not be controlled individually, but should count against the expenditure and rate limit of the rating authority (paragraph 13).

(vi) The Bill should provide for the Secretary of State to require rate reductions, as well as to restrain rate increases (paragraph 15).

(vii) Ministers should express a preference on the form of operation of selective control as between Options A and B (paragraphs 17-21);

- Option A Authorities rate limits set on the basis of expenditure figures approved after detailed scrutiny of draft budgets sent in October by all selected authorities.

- Option B Authorities rate limits set on the basis of formula expenditure targets set in July as amended on derogations from authorities unable to manage within target.

Officials recommend Option B because it would reduce the risk of legal challenge and be much simpler administratively.

(viii) The Bill should provide for a power to attach conditions to the determination of a rate (paragraph 23).

(ix) There should be no specific statutory role for management consultants in negotiations about rate levels (paragraph 24).

(x) Approved expenditure can be translated into maximum rate limits on the basis of a formula or, after taking into account the balances held by authorities. (paragraphs 26-29). Ministers are asked to express a preference.

(xi) The Secretary of State should take powers to require the provision of information and to make assumptions, which would not be legally challengeable, if authorities failed to co-operate (paragraph 30).

(xi.a) Scrutiny of authorities' budgets may require the Secretary of State to have regard to rents and fares. The implications of legislation on Protected Expenditure Levels (PELs) and rents will need to be investigated (paragraph 22).

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Relationship with expenditure targets

(xii) Decisions on the future of targets in the context of selective control need not be taken until 1984; until then Ministers need say publicly only that the relationship with the control scheme is being considered (paragraph 34).

Parliamentary procedure

(xiii) Where agreement is reached between the Secretary of State and the local authority on expenditure and rate levels, rate limits should be set by direction or Order by the Secretary of State without reference to Parliament (paragraph 35).

(xiv) Where there is disagreement about expenditure levels, or agreement about expenditure but not about rate levels, those rate levels should be set by an Order subject to affirmative resolution. Such an Order should preferably be capable of covering several authorities at a time (paragraph 35 and 36).

(xv) Authorities should have power to set an interim rate where agreement has not been reached before the normal date for setting a rate; and power subsequently to levy a larger final rate if a limit higher than the interim is eventually agreed, or to approve temporary borrowing in appropriate cases (paragraph 35)".

(xvi) Arrangements in Government should be made to ensure that Departmental circulars and subordinate legislation do not impose financial burdens on authorities inconsistent with the control scheme (paragraph 27).

C. General control scheme

(i) A transfer from selective to general control should be effected by statutory instruments subject to affirmative resolution (paragraph 40).

(ii) Legislation should be prepared on the basis of either Model 1 or Model 2, described in paragraphs 38-47.

- Model 1 Standard rate increases determined by the Secretary of State - subject to adjustments to base line rates. Authorities' permitted expenditure determined in December each year by combination of rate income and grant entitlement. Applications for derogations dealt with after RSG Settlement.

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- Model 2 Authorities set reasonable expenditure levels in July - applications for derogation made from late summer onwards. After RSG settlement approved expenditure translated into permitted rate levels for each authority sufficient to finance approved expenditure.

Officials recommend Model 2.

(iii) The Secretary of State should have power to attach conditions to derogations granted (paragraph 48(i)).

(iv) One such condition might be to require a review by consultants of particular aspects of an authority's services (paragraph 48(ii)).

(v) Power should be taken to allow the Secretary of State to take into account authorities' balances (paragraph 48(iii)).

(vi) Grant holdback would be superfluous under a general scheme (paragraph 48(iv)).

(vii) Parliament would approve rate levels for all authorities in a single order. Derogations from the general limits could be granted by the Secretary of State without further reference to Parliament (paragraph 48(v)).

(viii) As in the selective control scheme, there should be a power to set interim rates and allow higher or lower final rates and approve temporary borrowing where appropriate (paragraph 48(vi)).

(ix) Small authorities should be excluded from general control (paragraph 48(vii)).

(x) Further consideration of whether parish precepts should count against the expenditure and rate limit of the rating authority, and a submission will be made in due course.

(xi) Authorities' income from fees, rents, fares and charges should be allowed to remain as safety valves, as officials recommend (paragraph 48(x)).

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h). Default and intervention

(i) Whether to prepare legislation in anticipation that authorities resisting control may default from their obligations; by providing for the appointment of Commissioners (paragraph 52).

(ii) Whether to legislate in the main Control Bill; in a separate Bill in the 1984/85 Session; or to be ready to legislate in the light of authorities' response to control (paragraphs 52-54).

LOCAL GOVERNMENT SPENDING AND RATE SUPPORT GRANT

A. BACKGROUND

1. The three main developments since 1979 have been

- a. introduction of block grant;
- b. the introduction of a new way of measuring local authorities' spending needs;
- c. the introduction of expenditure targets for individual authorities, and holdback of grant if these targets are exceeded.

a. Introduction of Block Grant

2. Block grant has some similarities to the "unitary grant" proposed by the Layfield Committee in 1976. It was introduced in time for use in the 1981/82 Rate Support Grant (RSG) settlement. It replaced the old needs and resources elements of RSG by combining them. Its main objectives remain the same as the old needs and resources elements; that is

- i. to compensate authorities for differences in their rateable resources;
- ii. to compensate authorities for differences in their expenditure needs.

3. The main differences are:

First grant is based on expenditure in the grant year rather than, as in the case of the old resources element, the amount that authorities choose to rate for. This means that final grant entitlements cannot be made until after the end of the grant year when outturn expenditure is known.

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Second by use of a tariff of rate poundages, known as the poundage schedule, it sets the level of rate contribution from ratepayers required for any level of spending and makes explicit the relationship between expenditure, rates and grant. In practice, by use of a taper in the poundage schedule, block grant has operated in such a way that more of the burden of financing high level of spending - measured in relation to the assessed costs of providing an average standard level of service - falls onto local ratepayers.

Third it compensates more effectively for differences between authorities in their rateable resources. It no longer allows the richest authorities in rateable terms to keep the full benefits. This means that such authorities have "negative" marginal rates of grant" - that is as their expenditure increases, their grant falls. Depending on the level of each authority's expenditure, £1 extra expenditure per head is deemed to cost the ratepayers either a 0.6p rate or a 0.75p rate. If the yield of a 0.6p or a 0.75p rate is greater than £1 per head, then block grant is reduced accordingly. This is not a penalty. It prevents the richer authorities from being able to finance extra expenditure at lower rate poundages than poorer authorities.

Fourth block grant, unlike its predecessor, is now paid directly to all classes of authority - including metropolitan counties and non-metropolitan districts.

Fifth it incorporates simpler arrangements for sharing the benefits of the very high rateable values in central London both between London and the rest of the country, and within London.

b. Grant Related Expenditure Assessments

4. Before 1981/82, local authorities' expenditure needs were measured by needs of regression analysis, which aimed to "explain" authorities' expenditure in terms of a range of factors. In 1981/82 this method of assessment was replaced by grant related expenditure

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assessments. These assessments are done on a service by service basis. The basic method is a unit cost client/group approach under which needs are measured as follows. Needs = number of clients (e.g. schoolchildren) MULTIPLIED by unit costs - where assessment of both their numbers and unit costs varies between local authorities. In practice this approach covers a large proportion of GRES, including education and personal social services. There are however other services where this approach is not feasible and where GRES are based either on regression analysis or standard amounts per head.

5. Because it is service based, the new approach incorporates many more new indicators (up to 60) than its predecessor, and these are chosen to reflect the particular circumstances of each service. Because regression analysis is used less widely, and for a more limited purpose, GRES are less closely related to actual patterns of spending.

6. The new system is more flexible than its predecessor. There would be no undue difficulty in making the adjustments necessary to secure a different overall pattern of grant distribution. But as with its predecessor, the effects on individual authorities cannot be manipulated in advance. Grant shares by class of authorities since 1980/81 are shown at Table 1.

c. Local Government Spending Since 1979

7. Since 1979, local government current expenditure in England has continued to rise in volume and cost terms as well as in cash. (The volume series is expenditure adjusted for changes in pay and prices of the inputs employed by local authorities. The cost terms series is expenditure adjusted for changes in prices in the whole economy as measured by the GDP deflator.) Although the volume of expenditure fell in 1980/81 and again in 1981/82, local authorities' budgets for 1983/84 show expenditure 4% above the 1978/79 level (see Table 2).

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d. Aggregate Level of Exchequer Grant (AEG)

8. AEG in England has fallen from 60.1% of planned expenditure in 1980/81 to 52.8% in 1983/84 (before grant holdback) - equivalent to a £1.6 billion in grant support. The grant percentage has fallen from 57.2% of local authorities' actual spending in 1980/81 to 51.1% of their budgeted expenditure in 1983/84 (before grant holdback). This reduction in grant support has been one method of putting pressure on local government to reduce expenditure. Because authorities have not met the previous government's expenditure targets, the burden of rates has increased.

e. Expenditure Targets and Grant Holdback

9. Before 1981/82, pressure on local government expenditure was imposed in aggregate terms, through exhortation and cuts in the grant percentage. The imposition in 1981/82 and onwards of expenditure targets and grant holdback for exceeding these targets enabled further pressures to be imposed on individual authorities directly.

10. For 1983/84, most high spending authorities were given a target of 1982/83 budget minus 1%. Most low spending authorities were given a target of 1982/83 budget plus 4%. For each of the first two percentage points of spending above target, authorities' block grant is reduced by the equivalent of a 1p rate at ratepayer level. For each percentage point thereafter, grant holdback is set at 5p at ratepayer level.

11. The City, Westminster, Camden, the GLC and ILEA will not be subject to holdback in 1983/84, since they will not be receiving block grant. Our latest estimate of holdback for 1983/84 is £290m (compared with £301m in 1982/83).

July.

Criteria for Selection for Control

1. There is no unambiguous measurement of high spending. Authorities' expenditure can be compared with a number of other measures: eg

1. With GRE - a formula based assessment of the cost of providing an average standard of service.
2. With Expenditure Targets - these are set each year with the aim of representing the maximum expenditure reduction that an authority could be expected to achieve.
3. With Expenditure in a base year - this simply shows the relative increases in authorities' spending. There is no agreed neutral base year for such comparisons.

2. Each of these bases of comparison can be multiplied

1. Comparison with GRE can be measured in percentage points or percapita. Percapita comparisons are used in determining grant entitlements.
2. Comparison with expenditure targets is usually in percentage points but comparisons in cash identify the largest contributors to aggregate overspending.
3. Changes in Expenditure from a base year can be measured in terms of total expenditure ie all expenditure failing to be met from rates after deducting income from fees, rents and charges and specific and supplementary grants. Alternatively comparisons can be made of changes in current expenditure ie broadly that part of an authority's expenditure not going to finance debt, capital programmes or the Housing Revenue Account.

Different base years are available from 1981/82 in the case of total expenditure comparisons or for many years in the case of current expenditure - certainly from 1978/79, the Government's first year of office.

3. There are also proxies for comparing expenditure

1. Rate levels - which correspond closely with expenditure per head comparisons with GRE because of the operation of the grant system.

2. Rate increases - over 1 year, rate increases are very unpredictable because of the use of balances. Over a longer period they are a proxy for expenditure increases but are far from perfect because of the effect of grant distributional changes.

3. Comparative Manpower Levels - on average manpower accounts for 70% of local authority costs. High relative manpower levels could therefore be a measure of relative spending but it is a very indirect measure and the data collected for each authority is not available as full time equivalents to allow for fair comparisons.

4. Authorities expenditure can look very different on different expenditure criteria. The attached table shows how authorities' different expenditure measures compare by ranking them on 4 different criteria. Comparison of the rank order markings is an indication of the extent of variation.

5. This variability could lead to some difficulties in defending any particular selection of authorities for control on the grounds that their expenditure is excessive. The attached diagram attempts to show the extent to which different characteristics of overspending overlap and the extent to which they do not.

CHOICE OF LOCAL AUTHORITIES FOR SELECTIVE CONTROL
(RER Budgets, Settlement GREs)

(Omitting authorities with RER budgets less than £10m)

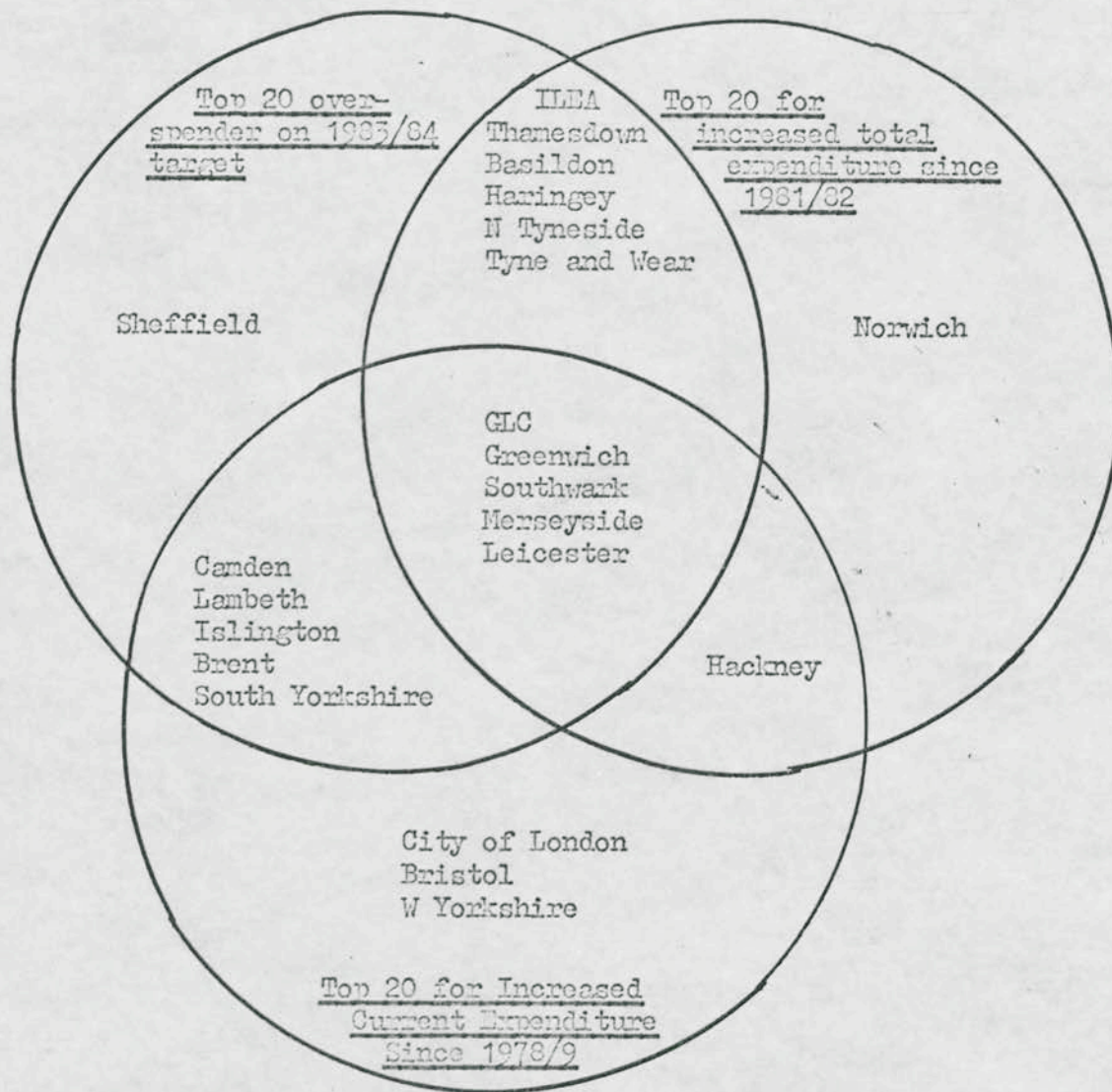
| | -----OVERSPENDING ON GRF----- | | OVERSPENDING ON TARGET | | ++++SPENDING INCREASE++++ | | | |
|------------------------|-------------------------------|------------------|------------------------|-------------|----------------------------|--------|-----|--------|
| | ---Percentage--- | ---Per capita--- | | | SINCE 81/82 REVISED BUDGET | | | |
| | RANK | AMOUNT | RANK | AMOUNT | RANK | AMOUNT | | |
| City of London | 1 | 229.72% | 1 | £7,262.43ph | 69 | 1.73% | 134 | 2.95% |
| Thamesdown | 2 | 86.18% | 24 | £43.81ph | 16 | 6.79% | 7 | 20.73% |
| GLC | 3 | 80.66% | 20 | £56.58ph | 1 | 53.24% | 1 | 91.55% |
| South Yorkshire | 4 | 76.03% | 21 | £55.55ph | 20 | 5.95% | 39 | 14.03% |
| ILEA | 5 | 65.91% | 5 | £143.53ph | 5 | 12.78% | 6 | 23.03% |
| Camden | 6 | 64.74% | 2 | £233.18ph | 11 | 8.63% | 92 | 9.44% |
| Greenwich | 7 | 62.93% | 9 | £113.11ph | 2 | 20.98% | 4 | 26.15% |
| Tower Hamlets | 8 | 60.20% | 4 | £163.15ph | 47 | 2.54% | 71 | 11.04% |
| Lansborough | 9 | 51.34% | 36 | £30.29ph | 138 | -4.04% | 118 | 6.53% |
| Lewisham | 10 | 50.73% | 10 | £107.41ph | 36 | 3.43% | 129 | 4.67% |
| Basildon | 11 | 50.22% | 40 | £27.49ph | 6 | 10.49% | 19 | 17.10% |
| Lambeth | 12 | 39.15% | 6 | £119.89ph | 8 | 9.53% | 64 | 11.29% |
| Hackney | 13 | 37.28% | 7 | £118.63ph | 27 | 4.50% | 5 | 24.89% |
| Harinsay | 14 | 36.77% | 3 | £169.85ph | 10 | 8.75% | 8 | 20.08% |
| Bristol | 15 | 34.52% | 49 | £21.02ph | 137 | -3.62% | 138 | -1.60% |
| Southwark | 16 | 34.48% | 8 | £116.89ph | 3 | 16.73% | 11 | 18.12% |
| Middlesbrough | 17 | 33.81% | 43 | £25.34ph | 85 | .57% | 95 | 8.65% |
| Norwich | 18 | 33.29% | 50 | £21.00ph | 77 | 1.32% | 9 | 19.28% |
| Reading | 19 | 33.11% | 54 | £19.39ph | 80 | 1.12% | 133 | 3.09% |
| Merseyside | 20 | 31.61% | 39 | £28.04ph | 9 | 9.14% | 16 | 17.76% |
| Newcastle upon Tyne | 21 | 30.99% | 12 | £104.76ph | 25 | 4.57% | 78 | 10.53% |
| Islington | 22 | 28.00% | 14 | £99.22ph | 7 | 9.83% | 62 | 11.95% |
| Tyne and Wear | 23 | 27.43% | 41 | £27.04ph | 12 | 8.01% | 13 | 18.04% |
| Blackburn | 24 | 27.24% | 52 | £20.47ph | 82 | .76% | 83 | 10.11% |
| Sheffield | 25 | 26.47% | 15 | £84.34ph | 14 | 6.93% | 58 | 12.21% |
| Manchester | 26 | 25.64% | 11 | £107.39ph | 76 | 1.36% | 132 | 3.19% |
| Leicester | 27 | 24.07% | 60 | £17.26ph | 4 | 13.77% | 2 | 30.73% |
| Brent | 28 | 22.96% | 13 | £103.80ph | 17 | 6.59% | 23 | 16.69% |
| North Tyneside | 29 | 22.04% | 18 | £69.93ph | 18 | 6.21% | 12 | 18.11% |
| West Yorkshire | 30 | 21.98% | 62 | £16.64ph | 55 | 2.00% | 131 | 3.88% |
| Hammersmith and Fulham | 31 | 21.81% | 19 | £66.12ph | 89 | .30% | 74 | 10.76% |
| Brighton | 32 | 20.58% | 64 | £14.96ph | 128 | -.23% | 65 | 11.26% |
| Waltham Forest | 33 | 18.87% | 16 | £78.64ph | 83 | .68% | 88 | 9.89% |
| Greater Manchester | 34 | 18.78% | 63 | £15.11ph | 15 | 6.88% | 27 | 15.19% |
| Stockton-on-Tees | 35 | 17.89% | 75 | £9.60ph | 106 | - | 137 | 1.12% |
| Newham | 36 | 15.32% | 17 | £78.38ph | 19 | 6.15% | 37 | 14.15% |
| Hounslow | 37 | 13.52% | 22 | £50.59ph | 30 | 3.89% | 117 | 6.61% |
| Rochdale | 38 | 13.51% | 23 | £48.20ph | 41 | 2.93% | 70 | 11.05% |
| Doncaster | 39 | 12.99% | 26 | £41.64ph | 39 | 2.93% | 109 | 7.36% |
| West Midlands | 40 | 12.88% | 72 | £10.39ph | 13 | 7.58% | 135 | 2.51% |
| Barkings and Basenham | 41 | 12.05% | 25 | £41.76ph | 112 | - | 136 | 2.24% |
| Gateshead | 42 | 11.73% | 27 | £38.00ph | 26 | 4.51% | 38 | 14.11% |
| Barnsley | 43 | 11.67% | 31 | £35.76ph | 51 | 2.30% | 121 | 5.94% |
| Hillingsdon | 44 | 11.15% | 29 | £37.79ph | 70 | 1.72% | 102 | 7.79% |
| Harrow | 45 | 11.02% | 32 | £35.75ph | 62 | 1.99% | 84 | 10.06% |
| South Tyneside | 46 | 10.87% | 28 | £37.83ph | 53 | 2.24% | 111 | 7.13% |
| Avon | 47 | 10.29% | 34 | £32.04ph | 22 | 5.14% | 24 | 16.16% |
| Liverpool | 48 | 9.50% | 30 | £36.67ph | 45 | 2.66% | 110 | 7.23% |
| Salford | 49 | 9.44% | 33 | £33.15ph | 43 | 2.83% | 86 | 9.98% |
| Portsmouth | 50 | 9.39% | 77 | £7.46ph | 32 | 3.76% | 59 | 12.16% |
| Sunderland | 51 | 8.61% | 38 | £28.13ph | 24 | 4.63% | 98 | 8.54% |
| Tameside | 52 | 8.59% | 37 | £28.58ph | 37 | 3.27% | 75 | 10.67% |

| | -----OVERSPENDING ON GRE----- | | | | OVERSPENDING ON TARGET | | ++++SPENDING INCREASE++++ | |
|----------------------|-------------------------------|--------|--------------------|----------|------------------------|--------|----------------------------|--------|
| | --Percentage-- | | ----Per capita---- | | RANK | AMOUNT | SINCE 81/82 REVISED BUDGET | |
| | RANK | AMOUNT | RANK | AMOUNT | RANK | AMOUNT | RANK | AMOUNT |
| Cleveland | 53 | 8.13% | 35 | £30.41ph | 34 | 3.64% | 97 | 8.59% |
| St Helens | 54 | 7.16% | 44 | £24.54ph | 29 | 4.06% | 91 | 9.63% |
| Knowsley | 55 | 7.07% | 42 | £26.40ph | 50 | 2.33% | 82 | 10.22% |
| Kinston upon Hull | 56 | 6.57% | 85 | £4.68ph | 38 | 3.10% | 60 | 12.15% |
| Haverins | 57 | 6.55% | 48 | £21.28ph | 123 | - | 127 | 4.81% |
| Wigan | 58 | 6.50% | 51 | £20.98ph | 72 | 1.66% | 101 | 8.36% |
| Bexley | 59 | 6.46% | 46 | £21.96ph | 64 | 1.92% | 116 | 6.70% |
| Richmond-upon-Thames | 60 | 6.34% | 56 | £18.70ph | 46 | 2.57% | 108 | 7.37% |
| Cheshire | 61 | 6.31% | 47 | £21.63ph | 40 | 2.93% | 73 | 10.84% |
| Bedfordshire | 62 | 6.30% | 45 | £27.07ph | 63 | 1.98% | 42 | 13.60% |
| Bury | 63 | 6.06% | 55 | £18.79ph | 68 | 1.78% | 85 | 10.05% |
| Durham | 64 | 5.73% | 57 | £18.41ph | 48 | 2.50% | 114 | 6.83% |
| Westminster | 65 | 5.68% | 58 | £18.34ph | 98 | - | 55 | 12.78% |
| Humberside | 66 | 5.67% | 53 | £19.94ph | 31 | 3.86% | 34 | 14.32% |
| Cumbria | 67 | 5.40% | 59 | £17.88ph | 23 | 4.71% | 72 | 10.94% |
| Nottinshamshire | 68 | 4.98% | 61 | £16.92ph | 49 | 2.45% | 53 | 12.84% |
| Calderdale | 69 | 4.46% | 45 | £14.58ph | 54 | 2.06% | 66 | 11.26% |
| Northumberland | 70 | 4.11% | 67 | £13.73ph | 33 | 3.71% | 79 | 10.40% |
| Derbyshire | 71 | 4.01% | 69 | £13.15ph | 28 | 4.35% | 10 | 18.54% |
| Rotherham | 72 | 3.98% | 70 | £12.90ph | 91 | .16% | 130 | 4.17% |
| Walsall | 73 | 3.94% | 66 | £14.02ph | 42 | 2.85% | 43 | 13.56% |
| Bradford | 74 | 3.78% | 68 | £13.39ph | 71 | 1.70% | 22 | 17.05% |
| Somerset | 75 | 3.42% | 71 | £10.67ph | 56 | 2.00% | 29 | 15.12% |
| Barnet | 76 | 3.24% | 73 | £10.30ph | 110 | - | 90 | 9.75% |
| Northampton | 77 | 3.11% | 93 | £1.92ph | 122 | - | 105 | 7.62% |
| Berkshire | 78 | 2.88% | 76 | £9.32ph | 52 | 2.24% | 21 | 17.06% |
| Coventry | 79 | 2.78% | 74 | £10.01ph | 109 | - | 61 | 12.04% |
| Enfield | 80 | 2.08% | 78 | £7.29ph | 73 | 1.63% | 104 | 7.67% |
| Blackpool | 81 | 2.05% | 95 | £1.41ph | 21 | 5.24% | 44 | 13.52% |
| Staffordshire | 82 | 2.04% | 79 | £6.76ph | 67 | 1.80% | 52 | 12.98% |
| Hertfordshire | 83 | 1.93% | 80 | £6.19ph | 84 | .59% | 77 | 10.57% |
| Mirral | 84 | 1.82% | 83 | £5.94ph | 78 | 1.25% | 68 | 11.22% |
| Kinston-upon-Thames | 85 | 1.82% | 81 | £5.96ph | 95 | - | 125 | 5.21% |
| Herton | 86 | 1.76% | 82 | £5.95ph | 75 | 1.39% | 103 | 7.71% |
| Wakefield | 87 | 1.72% | 84 | £5.29ph | 124 | -.01% | 126 | 4.94% |
| Leeds | 88 | 1.32% | 86 | £4.21ph | 130 | -.42% | 35 | 14.32% |
| Kirklees | 89 | 1.20% | 87 | £4.08ph | 61 | 2.00% | 50 | 13.03% |
| Lancashire | 90 | .92% | 88 | £3.11ph | 60 | 2.00% | 40 | 13.88% |
| North Yorkshire | 91 | .85% | 91 | £2.69ph | 94 | - | 89 | 9.77% |
| Warwickshire | 92 | .83% | 90 | £2.70ph | 81 | .96% | 18 | 17.47% |
| Ealins | 93 | .74% | 89 | £2.90ph | 125 | -.08% | 80 | 10.33% |
| Isle of Wight | 94 | .70% | 92 | £2.29ph | 74 | 1.52% | 26 | 15.46% |
| Sutton | 95 | .47% | 94 | £1.48ph | 121 | - | 107 | 7.48% |
| Oxfordshire | 96 | .42% | 96 | £1.29ph | 115 | - | 96 | 8.60% |
| Buckinghamshire | 97 | .18% | 97 | £.62ph | 35 | 3.45% | 14 | 17.80% |
| Metropolitan police | 98 | .01% | 98 | - | 93 | .01% | 3 | 30.20% |
| Suffolk | 99 | - | 99 | £-.01ph | 88 | .32% | 31 | 15.08% |
| Bromley | 100 | -.03% | 100 | £-.09ph | 127 | -.09% | 112 | 7.07% |
| Surrey | 101 | -.08% | 103 | £-.24ph | 65 | 1.90% | 57 | 12.36% |
| Southampton | 102 | -.25% | 102 | £-.16ph | 126 | -.09% | 122 | 5.54% |
| Derby | 103 | -.27% | 101 | £-.15ph | 116 | - | 94 | 9.16% |
| Hampshire | 104 | -.28% | 104 | £-.90ph | 114 | - | 67 | 11.24% |
| Gloucestershire | 105 | -.37% | 105 | £-1.18ph | 129 | -.39% | 69 | 11.06% |
| Trafford | 106 | -.41% | 106 | £-1.31ph | 117 | - | 87 | 9.95% |
| Wolverhampton | 107 | -.45% | 108 | £-1.75ph | 119 | - | 120 | 6.27% |
| Dorset | 108 | -.54% | 107 | £-1.63ph | 118 | - | 128 | 4.74% |

| | -----OVERSPENDING ON GRE----- | | OVERSPENDING ON TARGET | | ++++SPENDING INCREASE++++ | | | |
|------------------------|-------------------------------|---------|------------------------|-----------|----------------------------|--------|-----|--------|
| | --Percentase-- | ---- | ---- | ---- | SINCE 81/82 REVISED BUDGET | | | |
| | RANK | AMOUNT | RANK | AMOUNT | RANK | AMOUNT | | |
| Stockport | 109 | -0.79% | 110 | £-2.43ph | 131 | -0.50% | 93 | 9.19% |
| Oldham | 110 | -0.88% | 115 | £-3.25ph | 90 | .18% | 63 | 11.49% |
| Cambridgeshire | 111 | -0.99% | 114 | £-3.24ph | 57 | 2.00% | 33 | 14.37% |
| Kensington and Chelsea | 112 | -1.02% | 112 | £-2.69ph | 132 | -1.48% | 115 | 6.82% |
| Leicestershire | 113 | -1.08% | 116 | £-3.66ph | 96 | - | 15 | 17.78% |
| East Sussex | 114 | -1.32% | 117 | £-3.90ph | 97 | - | 99 | 8.47% |
| Hereford and Worcester | 115 | -1.38% | 119 | £-4.48ph | 99 | - | 46 | 13.45% |
| Devon | 116 | -1.38% | 118 | £-4.30ph | 59 | 2.00% | 28 | 15.13% |
| Lincolnshire | 117 | -1.62% | 120 | £-5.38ph | 100 | - | 47 | 13.34% |
| Essex | 118 | -2.02% | 121 | £-6.45ph | 101 | - | 25 | 15.66% |
| Bolton | 119 | -2.05% | 123 | £-7.09ph | 92 | .08% | 45 | 13.49% |
| Redbridge | 120 | -2.09% | 122 | £-6.86ph | 134 | -1.96% | 100 | 8.47% |
| Northamptonshire | 121 | -2.11% | 125 | £-7.39ph | 103 | - | 17 | 17.50% |
| Wiltshire | 122 | -2.21% | 124 | £-7.26ph | 102 | - | 48 | 13.19% |
| Sandwell | 123 | -2.29% | 126 | £-8.33ph | 104 | - | 119 | 6.49% |
| Norfolk | 124 | -2.92% | 127 | £-9.15ph | 87 | .39% | 56 | 12.56% |
| Shropshire | 125 | -3.58% | 131 | £-12.17ph | 108 | - | 30 | 15.12% |
| Cornwall | 126 | -3.69% | 129 | £-11.99ph | 58 | 2.00% | 32 | 14.47% |
| Notttingham | 127 | -3.79% | 111 | £-2.64ph | 44 | 2.77% | 76 | 10.62% |
| West Sussex | 128 | -4.09% | 128 | £-11.92ph | 105 | - | 51 | 13.02% |
| Stoke-on-Trent | 129 | -4.21% | 109 | £-2.31ph | 86 | .48% | 36 | 14.30% |
| Kent | 130 | -4.51% | 134 | £-14.69ph | 66 | 1.89% | 49 | 13.05% |
| Sefton | 131 | -4.67% | 133 | £-14.52ph | 79 | 1.17% | 81 | 10.24% |
| Southend-on-Sea | 132 | -4.69% | 113 | £-3.17ph | 133 | -1.54% | 113 | 7.00% |
| Wandsworth | 133 | -5.39% | 132 | £-13.11ph | 135 | -2.08% | 123 | 5.48% |
| Solihull | 134 | -6.15% | 135 | £-20.36ph | 111 | - | 54 | 12.80% |
| Birmingham | 135 | -6.19% | 138 | £-23.39ph | 136 | -3.23% | 124 | 5.23% |
| Croydon | 136 | -6.27% | 136 | £-21.69ph | 113 | - | 106 | 7.56% |
| Dudley | 137 | -7.66% | 137 | £-23.01ph | 120 | - | 41 | 13.68% |
| Plymouth | 138 | -21.31% | 130 | £-12.01ph | 107 | - | 20 | 17.08% |

FLGR Division 23 June 1983

DIAGRAM ILLUSTRATING OTHER HIGH SPENDING CHARACTERISTICS EXHIBITED BY THE 32 MAJOR AUTHORITIES SPENDING MORE THAN 20% ABOVE GRE IN 1983/84



Ten authorities more than 20% above 1983/84 GRE do not come into any of the other categories of high spending: Tower Hamlets, Langbaugh, Lewisham, Middlesborough, Reading, Newcastle on Tyne, Blackburn, Manchester, Hammersmith and Fulham, Brighton.

1. Top 20 overspenders on target are all more than 6% above 1983/84 targets.
2. Top 20 for increased total expenditure since 1981 have all increased by more than 17% in cash.
3. Top 20 for increased current expenditure since 1978/9 have all increased by more than 97% in cash.

3 Authorities in category 1, 7 in category 2 and 6 in category 3 are not among the 32 Authorities spending more than 20% above target.

Major authorities have been taken to ^{be} those spending more than £10m in 1983/84.

YEARLY TIMETABLE FOR SELECTIVE CONTROL OF HIGH SPENDING AUTHORITIES

April to June Identify authorities for control on the basis of budget returns and rate levels.

July (Year 0) (Scheme A)

Selected authorities informed that draft budgets for following year must be submitted by mid-October and that they cannot make a rate for Year 1 until the Secretary of State determines an interim or final figure.

October draft budgets submitted.

DOE scrutinises them in consultation with other service Departments and the authority.

December Authorities told of maximum expenditure level the S of S proposes to accept in setting maximum rate after the RSG settlement.

Authorities may still be in disagreement.

July (Year 0) (Scheme B)

Target expenditure levels for selected authorities or all authorities, for Year 1 announced. Selected authorities told their rate levels will be set on the basis of their targets.

Late summer - December Selected authorities ^{select} derogations from target (increases in the expenditure level on which rates will be set). Some targets are revised (subject to any conditions). Authorities may still be in disagreement.

January On the basis of the RSG Settlement, rate limits proposed for selected authorities corresponding to the level of expenditure proposed and the authority's grant entitlement possibly making an allowance for changes in balances. Authorities are asked to say by a specified date whether they accept the proposed rate limit (and any conditions imposed with it). For authorities which accept, a formal determination of the maximum rate is made; any higher rates levied will be ultra vires. For authorities which do not accept, an interim rate determination is made, and further representations are considered. Authorities may disagree with the proposed rate limit because of the expenditure assumption or the way that has been translated into a rate level.

(into Year 1)

February - Onwards / The Secretary of State completed his further consideration and presents an order to Parliament seeking approval to those determinations of rate levels where disagreement remains. Where authorities have already levied an interim rate, following Parliamentary approval, they will be authorised by the Secretary of State to raise a supplementary rate or, in certain circumstances, make temporary borrowing.

Ref. A083/1313

PRIME MINISTER

Local Government Issues: General Handling

The Cabinet tomorrow will have three papers on local government issues before them. I suggest that it will be convenient to consider them in the following order.

2. First, C(83) 15 (local authority rates). As you will be well aware from E(LF), the issues are complicated and have not been considered in detail by the Cabinet before. The decisions on C(83) 15 may well condition decisions on the other papers.

3. Second, C(83) 13 (future of the GLC and the metropolitan county councils). This is a larger question than the future of the ILEA. Moreover, if it is decided that the GLC should be abolished, then there is no doubt that ILEA must be reconstituted. The question will be how, not whether.

4. Third, C(83) 12 (future of ILEA).

RIA

ROBERT ARMSTRONG

9 May 1983



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A083/1317

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PRIME MINISTER

Local Government Finance
and Taxation:

C(83)15

BACKGROUND

The Ministerial Group on Local Government Organisation and Finance (MISC 79) recommended making no large changes in the rating system. In particular, it recommended against replacing or supplementing the rates by any new form of locally-raised revenue, and against any system of direct control by central government of the rates or expenditure of individual local authorities. It did, however, put forward a package of relatively minor reforms of the rating system, of which the most important was a scheme of discounts for single-person households. The Cabinet decided that these recommendations were an inadequate response to the demands of the situation, and that it was essential to go further. They took no decision on the minor reforms recommended by MISC 79 (CC(83)1st Conclusions, Minute 7).

Flag A

2. You subsequently set up the Ministerial Sub-Committee on Local Government Finance (E(LF)) under your own chairmanship. This has now reached conclusions. These, with the results of a separate meeting which you held last week, are the basis of the current memorandum by the Secretary of State for the Environment (C(83)15). This recommends that there should be a system of control by central government of the rates of individual local authorities. Initially, at least, control would be applied selectively to a small number of high-rating and high-spending authorities. But the Government would also take reserve powers to introduce a general scheme applying to all local authorities. Legislation to provide the statutory basis for both schemes (but not the detailed criteria for their application, which would be left for secondary legislation) would be introduced in the 1983-84 Session of Parliament.

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3. Most of the minor reforms recommended by MISC 79 reappear in paragraphs 14 to 17 of C(83)15. However, the Secretary of State for the Environment suggests that if it is decided to mitigate the burden of rates by a control scheme it is unnecessary to pursue the proposed scheme of discounts for single-person households. As agreed by E(LF), he omits the proposal to hold a revaluation of non-domestic property in England and Wales, but adds a proposal that the discretion of local authorities to rate empty industrial property should be removed.

4. E(LF) reached no decision on a supplementary tax in addition to the rates; and it was clear that several of the Sub-Committee's members doubted the wisdom of such a tax. Paragraph 24 of C(83)15 proposes a form of words intended to keep the question open.

MAIN ISSUES

5. The main issues before the Cabinet are as follows.

- (i) Should there be a scheme of control by central government of the rates of individual local authorities?
- (ii) If so, should it be selective or general?
- (iii) Should other changes be made in the rating system?
- (iv) What should be the scope and timing of any legislation needed to give effect to the Cabinet's decisions of substance?
- (v) How should the Government's decisions be announced?
- (vi) What, if anything, should the announcement say about other possible sources of local revenue?

You are familiar with the issues; and this brief is largely an aide-memoire.



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Central Government Control of Rates

6. Some members of the Cabinet may argue that, whether for constitutional or practical reasons, it would be wrong for central government to control the rates of individual local authorities; others may be concerned at the potential conflict with local government interests, not least among the Government's own supporters. They may also point to the success of the Government's policies in reducing the average level of rate increases (see, for example, paragraph 2 of C(83)15) and suggest that it is unnecessary to go further. Some of your colleagues may also be concerned at the implications of any scheme of control for the position of Ministers with responsibilities for individual local authority services, especially in England: their decisions would, in effect, have to be subject to the decisions of the territorial Secretary of State on the permissible total of expenditure.

7. On the other hand, it can be argued that rate increases in some local authority areas are manifestly excessive, and that some local authorities show so little regard either for the interests of their own ratepayers or for the constitutional convention that central government is entitled to decide the totality of local authority expenditure that, at the very least, selective controls directed at the worst offenders are fully justified. There is also the question whether the Government can safely rely on the existing block grant and holdback mechanisms continuing to restrain local authority rates in all foreseeable circumstances.

Selective or general scheme?

8. Whether a scheme of control should be selective or general has been extensively discussed in E(LF). As you know, the essential arguments are:

In favour of a general scheme: that it would give a much larger number of ratepayers assurance against excessive rate increases and would be marginally less exposed to legal challenge;



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In favour of a selective scheme: that it would be less likely to generate an unmanageable number of cases requiring extensive Ministerial and official consideration, and would probably be more easily accepted by local government interests.

In effect, the proposals in C(83)15 aim to get the best of both worlds by threatening to introduce a general scheme if local authorities do not behave responsibly.

Other changes in the rating system

9. Most of the more detailed recommendations in paragraphs 13 to 18 of C(83)15 are likely to be readily accepted by the Cabinet. Some Ministers may wish to press for the retention of the scheme of single-person discounts proposed by MISC 79. Certainly such a scheme would have presentational attractions in that it would deal directly with what is widely perceived as one of the main objections to rates: the single-person living next door to a family including several earners and paying the same rates as they do.

10. On the other hand, as MISC 79 itself recognised, there are good arguments against such a scheme.

(a) Many couples pay as much in rates as many single people from a smaller income and with more calls on that income.

(b) It is not necessarily true that the proverbial 'little old lady' living by herself makes no call on local authority services: she may be receiving a good deal of attention from the personal social services, and get a local authority home help and a bus pass.

(c) Rate rebates are there to deal with those on low incomes.

Some of the objections might be met by extending the scheme of discounts, for example to cover pensioner couples, but only at the expense of other anomalies and higher costs. The Cabinet may therefore conclude that it is unnecessary to pursue the scheme if it is decided to tackle the problem of excessive rates by direct control.



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11. The Cabinet is also unlikely to press for the reinstatement of the MISC 79 recommendation for an early revaluation of non-domestic property in England and Wales. But the logic of C(83)15 is that the rates are here to stay for a long time - perhaps indefinitely. Their base cannot really be left to get ever further out of line with reality. It may therefore be prudent to recognise that a revaluation will be needed later, if not sooner.

Scotland

12. The rating system in Scotland differs in several important respects from that in England and Wales, as does the system of controlling local authority expenditure. The Secretary of State for Scotland proposed to E(LF) a number of consequential of the likely English decisions: in particular, he indicated that he would wish to have new general powers of clawback from rate support grant to complement his existing selective powers over individual authorities, just as the Secretary of State for the Environment wants new selective powers to complement his existing general powers. He may therefore find paragraph 12 of C(83)15 unsatisfactory.

13. The Cabinet will probably not have time to discuss the Scottish implications in detail. They may therefore wish to invite the Secretary of State for Scotland to agree proposals, reflecting decisions on C(83)15, with the Secretaries of State for the Environment and Wales, and the Chief Secretary, Treasury, and to clear them with you as soon as possible: no doubt there will be heavy pressure for the Government to state its proposals for the Scottish rating system during the Election campaign.

Legislation

14. The legislative programme for the 1983-84 Session provides for legislation on local government finance; and there is unlikely to be any disagreement that legislation reflecting the Cabinet's decisions on C(83)15 should be presented as soon as possible. The only points likely to arise are as follows.

- (i) Is it right to legislate on both the selective and the general schemes in the same Bill? Doing so will make the



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Government determination to exercise effective control clearer; and it will avoid the possible need to pass two contentious Bills. But it will mean a very long and complicated single Bill, which may be more strongly opposed by local government interests fearful that the Government will move quickly to a general scheme of control.

(ii) Should default powers be held over for possible legislation in 1984-85 as proposed in paragraph 4 of C(83)15? It must be quite likely that some local authorities will defy the Government at once; unless the Government is willing to see local services collapse it will have to be ready to take them over. It can therefore be argued that default powers are a logical consequence of a control scheme, and that they should be included in the original legislation.

Announcements

15. In due course, it will no doubt be necessary to set out the details of the Government's proposals in a Green or White Paper. But the immediate need is for a brief, but clear, statement. The drafting of any immediate announcement of the detailed proposals in paragraphs 14 to 18 of C(83)15 can be left to the Secretary of State for the Environment, consulting you and the other colleagues directly concerned as necessary: the Cabinet will wish to concentrate on the form of words proposed in paragraph 24.

16. This form of words raises the question of what is to be said about an alternative tax to the rates. It is clear that the Government is not in ~~the~~ position to announce that it has decided in favour of a particular alternative or supplementary tax. Some of your colleagues may well wish to go further and say that the Government has decided not to introduce, at least at this stage, any new form of local taxation and intends to rely on direct control of the rates. In favour of such course it could be argued, in particular:

(i) that no alternative tax is likely to be popular; and



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(ii) that the proposed form of words is misleading, since it is clear from the E(LF) discussions that if an alternative tax could be introduced quickly the Government would still wish to limit the rates (it would indeed be easier to control rates if there were a 'safety valve'; and the need to control the expenditure of local authorities armed with two sources of taxation would be no smaller than it is now).

It might therefore be better to omit the opening clause of the fourth sentence of the draft and either to say that the Government have decided not to introduce a new form of local taxation, or that the Government are continuing to study the issues.

HANDLING

17. You will wish to invite the Secretary of State for the Environment to introduce his memorandum. You might then invite the Secretaries of State for Scotland and Wales, as the other local government Ministers, to contribute. The Chief Secretary, Treasury could then be invited to speak, as the main advocate of a scheme of general control of the rates and because of his responsibilities for the taxation system. All your colleagues are likely to wish to speak. The Attorney General will be present to deal with any technical legal questions.

CONCLUSIONS

18. You will wish the Cabinet to reach conclusions on the matters raised in paragraphs 23 and 24 of C(83)15.

RIA

R ARMSTRONG
Cabinet Office.
9 May 1983

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PRIME MINISTER

after the main meeting is over
MS

Tom King is coming in on Monday to discuss Somerset House with you. He will be very anxious to assure himself that the paper he is about to put round the Cabinet on rates is on the lines you wish. He will pick up the conclusions of your short meeting with Lord Bellwin and Terry Heiser on Friday -

i) That the decision is for both a selective and a general scheme, with the latter as a reserve power, held back as a threat in case the selective powers do not work.

ii) The aim will be to set out in outline only the criteria under which the selective powers will operate and under which the derogations from the general order would be permitted.

It would be left for later to devise the details, which could be put in place by secondary legislation.

iii) With such a broad ranging set of powers, there ought to be no need for the single person occupied rebate scheme costing £250-300m (although there still might be a case for the highly selective rebate schemes suggested by George Younger on Thursday).

You will wish also to concert with Tom King how best to rally opinion in the Cabinet round these conclusions in advance of the discussion on Thursday.

MS

6 May 1983

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VCC N.O.
Local Govt.

2 MARSHAM STREET
LONDON SW1P 3EB

01-212 3434

My ref:

Your ref:

6 May 1983

PA

Dem Michael

E(LF)

Following the meeting of E(LF) yesterday my Secretary of State has prepared the first draft of a paper for Cabinet. As I have explained to you, he is in Merseyside and Manchester today and the attached text has therefore been prepared by officials in the light of his instructions at a meeting last night. It was, therefore, prepared before the meeting which the Prime Minister had with Lord Bellwin this morning and does not reflect any points made in that discussion. A revised paper will be worked on again by the Secretary of State over the weekend. My Secretary of State had felt that it would be helpful if the Prime Minister had an opportunity to see this draft version at the earliest possible moment, but you may now feel that events have moved on to such an extent that this would not be useful. My Secretary of State would appreciate the opportunity of a word with the Prime Minister about the substance of a paper on Monday, prior to circulation to Cabinet colleagues.

We have also sent to Cabinet Office today the paper on the abolition of the GLC and Metropolitan Counties.

John
Dail

D A EDMONDS
Private Secretary

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COPY NO ...

LOCAL GOVERNMENT FINANCE AND TAXATION

1. Following Cabinet discussion of a report by MISC 79 on 20 January (C(83)1st, Item 7), there have been further discussions in E(LF) on the reform of rates. I now submit to colleagues further proposals that have emerged from those discussions.

2. When we took office in 1979, local government expenditure and manpower had risen relentlessly for many years. We took steps to reverse this trend, and we have had a certain degree of success. In England, manpower (excluding police) has fallen by about [] %]. Numbers employed are now lower than ^{at} any time since 1975. Moreover despite substantial cuts in rate support grant the average level of rate increases has fallen steadily as inflation has come under control - 6½% in 1983-84 as compared with 23% in 1980-81.

3. But we have a good way to go. There is still a totally unacceptable degree of waste and inefficiency in most local authorities of all political complexions. Domestic rates form a heavy burden on many households. Jobs in industry are being destroyed by extravagant and irresponsible spending policies, especially by Labour authorities in the urban areas.

LIMITS ON RATE INCREASES

4. Our experience has shown the major difficulties that can arise from direct intervention in the affairs of individual authorities. Nonetheless I believe that there is a political imperative to take action. I therefore consider that we must now commit ourselves to introduce legislation in 1983-84 which will protect ratepayers -

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domestic and non-domestic - from the quite unreasonable demands of the highest spending authorities; and also to be ready to introduce a general scheme of control to protect all ratepayers if the selective scheme does not have the desired effect. Such legislation would take effect on 1 April 1985.

Selective Scheme of Control

5. A scheme of selective control would be aimed at the authorities with the highest levels of spending. We would scrutinize all authorities against published criteria. Those whose levels of expenditure exceeded the limits set by the criteria would be required to submit their budgets for my approval not later than the autumn preceding the next financial year. Authorities so selected would be debarred from making a rate without my approval.

6. If a selective scheme had been applied to only the "top 15" authorities (see Annex A) in 1983-84, it would have protected 4m out of 17½m domestic ratepayers in England, as well as the non-domestic ratepayers in these areas. It is worth noting that despite a 3% reduction in the Exchequer grant between 1982-83 and 1983-84, if these authorities had met their spending targets this year, the average rate increase over the whole of Great Britain would have been about [1%] rather than about [6%].

7. I believe that other authorities would have a strong desire to stay well clear of the risk^{of} such intervention as our powers would permit.

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General scheme of control

8. The presentational attraction of a general scheme in which we would impose a strict limit on the rate increase each year are clear. To be attractive, the limit would certainly need to be at or below the rate of inflation, and apply to every local authority, whether a high spender or low spender. There would need to be a system of derogations to meet special circumstances, and there would be a clear risk of a substantial number of applications. There would need to be a statutory specification of eligible items designed to help reduce significantly the number of applications for derogations; enable me to reject applications more readily; and give a better chance of success in resisting legal challenges.

9. But in our discussions the Minister for Local Government has stated his strong belief that a general scheme, applicable to authorities of all persuasions, would alienate the majority of our supporters in local government. I agree with him. There is also the question whether a scheme implying control of all local authorities would be easy to legislate - not least in the House of Lords. For these reasons I believe we would be wise to advance a general scheme only on a contingent basis. My concern continues to be whether the criteria could provide a sufficient deterrent to keep the number of applications and court challenges down to reasonable proportions.

10. Any legislation on the control of rates will certainly shift the boundaries between central and local government in favour of the former. But the argument to justify this approach is that the traditional relationship between central and local government, in which local government accepted a responsibility to achieve the central government's

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expenditure plans, is being consciously challenged by a number of local authorities. Moreover the accountability of authorities to their electorates has been seriously eroded by the development of supplementary benefit and rate rebates.

10A. Any general scheme of control should apply to Great Britain as a whole.

RATING REFORMS

11. MISC 79 made a number of proposals for rating reform, which I have now reviewed in the light of our more recent discussions in E(LF). My immediate proposals are as follows: others can be considered later.

12. We should provide a discount for those domestic ratepayers who make relatively little use of local authority services. MISC 79 recommended a discount scheme confined to households consisting of a single adult living alone. There are 4.3m of these, and the proposed discount of 50% of the rate bill, up to a maximum of £1.50 a week, would cost about £150m a year. Queries have been raised as to whether this is the right category to benefit. Annex B shows other possible categories, with the numbers in each and the costs of applying a discount scheme to them. My own view is that we should introduce a discount applying to single adults living alone and all pensioner households. This would provide additional help to 2.5m households already in receipt of rebates and bring in another 1.1m at a total net cost of £240m a year.

13. Each of the main tiers of local government should provide a separate statement for each ratepayer (with a unified single bill). Council tenants should receive annual rate statements.

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14. Local authorities should be put under a statutory obligation to consult local representatives of industry and commerce before setting rates.

15. We should give more businesses the right to pay rates by instalments.

16. In addition to these proposals from MISC 79, I propose that we should stop the rating of empty industrial property as soon as possible.

ABOLITION OF THE GREATER LONDON COUNCIL (GLC) AND THE METROPOLITAN COUNTY COUNCILS (MCCs)

17. In addition to this package I believe that we should commit ourselves to the abolition of the GLC and the MCCs. They are widely recognized as a superfluous tier of local government, whose very existence tends to generate extravagant spending proposals.. Their abolition will be extremely popular. I am submitting a separate paper to Cabinet on this subject.

CONCLUSIONS

18. I invite colleagues to agree to:

a) legislation next Session to protect ratepayers from the demands of the highest spending authorities;

b) a commitment to a general scheme of control if a selective scheme does not have the desired effect;

c) legislation next Session to reform the rating system as described at paragraphs 12 to 16.

19. Cabinet will wish to consider the timing and form of any announcements.

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P.01011

PRIME MINISTER

Local Taxation: Control of Rate
Increases and Expenditure

E(LF)(83)11 and 12.

BACKGROUND

Tomorrow's meeting of the Sub-Committee is a resumption of the discussion on 27 April; and the same papers are relevant. In addition, as requested by the Sub-Committee (E(LF)(83)3rd Meeting, Conclusion 3), the Secretary of State for the Environment has circulated a memorandum (E(LF)(83)11) discussing the criteria which might be used:

FLAG BB. - - -

FLAG A - - -

(i) to decide which local authorities would be eligible for derogations under a general scheme of limitation on rate increases, such as that advocated by the Chief Secretary, Treasury in E(LF)(83)9; and

FLAG F - - -

(ii) to decide which local authorities would be chosen for selective scrutiny and control under the scheme advocated by the Secretary of State for the Environment in E(LF)(83)7.

FLAG C - - -

The Chief Secretary has circulated a memorandum (E(LF)(83)12) setting out a rather different approach to the criteria for a general scheme of limitation of rate increases.

FLAG B - - -

2. This brief discusses the two new memoranda. The brief I submitted for the previous meeting, which discusses E(LF)(83)7 to 10, stands. The Sub-Committee will need to reach decisions tomorrow on the matters raised in E(LF)(83)7 to 10 - which go a good deal wider than E(LF)(83)11 and 12 - if the Government is to be in a position to announce its decisions, even in outline, this month. The provisional arrangements for Cabinet meetings suggest that the Cabinet might consider rates

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and local taxation on 19 May (and it may well be that more than one meeting will be needed to resolve the issues). That leaves little time to prepare and circulate the papers on this notoriously complicated subject.

MAIN ISSUES

3. The main issues are as follows:

i. you will wish first to seek agreement on whether the interim scheme should involve a selective or general limitation of rate increases;

(if the issues are fully explored but agreement still cannot be reached, the right course may be to put this to the Cabinet as an unresolved matter, bearing in mind the tightness of the timetable)

ii. in the light of i. you will wish to seek agreement on whether a long term scheme is needed and, if so, what it should be and what should be the basis on which public consultation takes place;

iii. decisions are also required on the package of minor reforms (eg the discount for the single person household etc).

Selective v general scheme

4. A general scheme would have great political attraction in that it would offer all rate payers protection against excessive rate increases and not only those in a few authorities. The problem is whether it would work in practice. The crucial consideration is that the general limit would have to be set provisionally as early as July, and would have to be set on the low side so that it would not have the perverse effect of encouraging higher rate increases. The danger is that the Secretary of State would be swamped with a large number of applications for derogation; most of these applications might well be unsuccessful ultimately but the mere fact of having to consider them conscientiously and having to defend decisions on some of them in the courts would present the problem.

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5. The Secretary of State for the Environment argues in E(LF)(83)11 that the criteria for derogations cannot be drawn tightly enough to prevent this swamping effect. He has concluded that whether a narrow but general criterion was adopted or a specific list of considerations, authorities would still find it easy to put forward a prima facie case. In E(LF)(83)12 the Chief Secretary disagrees. He proposes a series of filters, initially quantitative and mechanistic but subsequently more subjective, designed to reduce the number of applications for derogations requiring intensive scrutiny to manageable proportions.

6. It may be felt that the Secretary of State for the Environment overstates a little the difficulties involved in devising criteria for derogation under a general scheme, for example:

i. it is suggested that local authorities might be able to cite pay increases as "unforeseen circumstances". Against this it might be argued that where the local authorities themselves negotiate the pay increases these are under their own control within the financial parameters already set for them; and that, since the pay increases apply generally, they could not provide grounds for derogation for particular authorities. It must however be admitted that the pay outturn will always tend to be higher than the assumption used in the previous July because this assumption will have been designed deliberately to lower expectations. It would be undesirable to have a system which was so tight that the Government had either to allow a large number of derogations or to force many local authorities into default.

ii. It is argued that, in order to avoid an unduly rigid system, any list of specific grounds for derogation would have to be supplemented by a general escape clause and that this would provide a potential way in for all local authorities. Against this it could be argued that the Secretary of State would be able to turn down promptly all such applications as were plainly unacceptable. It has to be admitted however that this would provide an uncomfortably wide area for challenging the Secretary of State's discretion in the courts.

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7. The conclusion may be therefore that even if some of the arguments in the Secretary of State for the Environment's paper may not bear all the weight he puts on them, they give some considerable grounds for anxiety about the workability of a general scheme.

8. In considering the Chief Secretary's paper (E(LF)(83)12) the Sub-Committee will wish to consider whether he plays down the difficulties of a general scheme unduly, for example:

i. It would certainly be convenient to have an initial filter of a mechanistic and quantitative kind. The question is how feasible this would be. Experience of the existing rules for block grants and holdback shows how difficult it is to apply strict quantitative rules of a general kind without producing nonsenses affecting individual local authorities. The tighter the initial criteria are set, the more likely it is that some local authority will be put into an impossible position, with no hope of derogation and possibly driven into default. If however the initial quantitative criteria are kept loose, they do not achieve the objective of cutting down the number of applications for derogation. It should also be noted that even the Chief Secretary's initial criteria are not wholly quantitative and include "emergencies and other unforeseeable contingencies", about which there would be some room for argument.

ii. The total effect of the Chief Secretary's proposals would be that the Government would determine in a complex and elaborate way the expenditure of all local authorities. There is of course no constitutional objection to this arrangement; if Parliament decides that the powers of local authorities should be so circumscribed, that is the end of the matter. Ministers will however need to weigh very carefully whether the political advantage of having a general as opposed to a selective scheme for limiting rate increases is sufficient to outweigh the political difficulty of circumscribing the powers of all local authorities in this way.

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Other issues

9. On the other issues you may wish to refer back to the earlier brief submitted on 26 April.

HANDLING

10. You will wish to ask the Secretary of State for the Environment and the Chief Secretary, Treasury to introduce their memoranda. All members of the Sub-Committee are likely to wish to contribute. Unfortunately, the Attorney General cannot be present because he will be in Belfast. But we understand that he takes the view that the legal issues have been thoroughly aired and that the decision now before the Sub-Committee is essentially a matter of policy.

CONCLUSIONS

11. You will wish to reach conclusions on the following matters:

- i. whether the interim scheme for limiting rate increases should be on a selective or a general basis;
- ii. whether there is the need for a longer term scheme involving an additional source of local taxation; and, if so, what it should be and on what basis should public consultation take place;
- iii. whether the following minor reforms should be introduced throughout Great Britain:
 - a. a discount for single person households;
 - b. separate billing of rate payers by different tiers of local government (already applying in Scotland);
 - c. a statutory obligation on local authorities to consult local representatives of industry and commerce;
 - d. revaluation of the non-domestic sector;
 - e. streamlining of valuation procedures;

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f. abolishing (or, as the Chief Secretary would prefer, reducing to 25 per cent of the full rate) rates on empty industrial property;

iv. whether the Secretary of State for Scotland should be authorised to go ahead with some reforms affecting Scotland only (eg domestic revaluation, and changes in valuation assessment and appeal procedures, and improvements in his grant-withholding powers.)

RG
P L GREGSON

4 May 1983

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PRIME MINISTER

E(LF) (83) 11 and 12

As I made clear in my minute of 26 April, I share the Environment Secretary's view that a selective scheme for controlling rate increases is preferable to a general scheme, and I would prefer further work to concentrate on that. There is one point I would add in relation to the Chief Secretary's memorandum (E(LF) (83) 12).

The Chief Secretary proposes general criteria, to be set out in legislation, which would prevent many local authorities seeking derogations from an imposed general limit on rate increases. The difficulty I see is that such criteria would have to be demonstrably compatible with the statutory educational duties of local education authorities. I think this might be difficult, though it is true one could not be certain without further work. The risk is that we should have local authorities complaining that they were being prevented by one Act from carrying out their statutory duties under another.

I am sending copies of this minute, as before, to the other members of E(LF) and to Sir Robert Armstrong.

ky.

4 MAY 1983

Mr. Loffhouse: Does the Chief Secretary recall that at a meeting earlier this month, NEDC said that there were no prospects of an increase in jobs in either the industrial or service sectors of industry during the course of this decade? Why do he and the Chancellor think that it was wrong?

Mr. Brittan: One of the reasons was that the sector committees, whose views were reflected in the report to which the hon. Gentleman, cover only about one third of the economy.

Mr. Budgen: Will my right hon. and learned Friend point out to NEDO that recently the west midlands has derived considerable advantage from the 13 per cent. fall in the sterling exchange rate and that the west midlands is prepared to support even the present very high level of interest rates if that is necessary to constrain any increase in the money supply, but is emphatically not prepared to support these levels of interest rates to sustain an uncompetitive rate of sterling?

Mr. Shore: Does the Chief Secretary recall that the last time he met and had discussions with the Neddy council on the most far-reaching report that it had had before it since the information of the Government, the general conclusion of the 30 sector committees that drew up the report said that there would be no increase in employment, on present policies, between now and 1990? What response will the Government make to this serious condemnation of their policies and the appalling prospects that lies ahead?

Mr. Brittan: As the right hon. Gentleman knows well, the view of the Government and the CBI is that the report was unnecessarily gloomy and that the sector committees whose work was reflected in that report have probably taken insufficient account of a number of recent favourable developments, including the rapid fall in inflation and the vast growth in industrial productivity.

PRIME MINISTER

Engagements

Q 1. **Mr. Tony Speller** asked the Prime Minister if she will list her official engagements for Thursday 28 April.

The Prime Minister (Mrs. Margaret Thatcher): This morning I presided at a meeting of the Cabinet and had meetings with ministerial colleagues and others. After my duties in the House I shall be leaving for an official visit to Sheffield and the east midlands.

Mr. Speller: I welcome my right hon. Friend's achievement in getting inflation down to its lowest level for 15 years and in getting realistic wage settlements. None the less, will she accept that the real rate of interest is the greatest disincentive to borrowing and business? Furthermore, will she accept that while labour and capital-intensive businesses such as agriculture, catering and manufacture are doing well on other fronts, the real cost of borrowing is the greatest disincentive to investment and prosperity?

The Prime Minister: I share my hon. Friend's views of the importance of interest rates, and I agree that low inflation and low interest rates provide the right framework

for recovery. As inflation falls further, so real interest rates, which are slightly high at the moment, will continue to come down.

Mr. Beith: Will the Prime Minister spend any time today on her plans for the rating system? Will she promise to abolish the rating system, and if so, will it be on the basis of the plans that she had in mind at the time of the last general election, or will she promise merely to reform the rating system?

The Prime Minister: There was no pledge to abolish rates in the last election manifesto—[*Interruption.*] In the last manifesto we clearly said—

Mr. Skinner: Speak up.

The Prime Minister:—that the reduction in income tax will have to come first. The hon. Gentleman will have to wait to see exactly what we say about rates when the time comes.

Q2. **Mr. Chapman** asked the Prime Minister if she will list her official engagements for Thursday 28 April.

The Prime Minister: I refer my hon. Friend to the reply that I gave some moments ago.

Mr. Chapman: The hon. Member for Berwick-upon-Tweed (Mr. Beith) spoke of rates. Will my right hon. Friend take time today to look at recently published statistics which show that the average rate poundage of Labour-controlled London boroughs is no less than 50 per cent. higher than it is for Conservative-controlled boroughs? Is my right hon. Friend aware that the equivalent figure for the metropolitan counties is 25 per cent., as it is in the shires? Does my right hon. Friend agree that the best advice to people is to vote Conservative at the local elections next week if they want to keep their rates down?

The Prime Minister: As my hon. Friend points out, there are many Labour-controlled local authorities that are big spenders of other people's money. This year, the 18 largest over-spenders are all Labour-controlled authorities. I agree with my hon. Friend that it is the duty of councillors to be careful how they spend ratepayers' money and to see that the ratepayers get value in every aspect of the councils' work.

Mr. Foot: If the right hon. Lady is now showing a renewed interest in the rating system, will she tell us by how much rates have increased under her Government?

The Prime Minister: Too much, especially in Labour-controlled authorities.

Mr. Foot: Have not the rates increased in general throughout the country under her Government by 75 per cent? By how much would that have been reduced had she not cut the rate support grant?

The Prime Minister: The rates are highest in Labour-controlled authorities. This year the 18 largest overspenders are all under Labour control. Among the 18 largest overspenders are the GLC, ILEA, the west midlands, Greater Manchester, Avon, Merseyside, Southwark, Sheffield, Derbyshire, Humberside, Greenwich, Tyne and Wear, Harringey, and south Yorkshire—all Labour-controlled. Labour loves spending other people's money.

Mr. Foot: Will the Prime Minister help us by saying how much the rates have increased in Surrey, which is controlled by the Conservatives?

The Prime Minister: They are much too high in Surrey this year. They are too high in many authorities. One of the ways of trying to reduce public expenditure in the local authorities was the new rate support grant system. On average, the rates are increasing this year by 6.5 per cent. Had the two biggest spenders—the GLC and ILEA—spent at their target there would have been, on average, virtually no rate increase this year.

Q3. Mr. Trippier asked the Prime Minister if she will list her official engagements for 28 April.

The Prime Minister: I refer my hon. Friend to the reply that I gave some moments ago.

Mr. Trippier: Has my right hon. Friend had time to study the essay which was written by the right hon. Member for Leeds, East (Mr. Healey) in the book called "Renewal. Labour Britain in the 1980s"? Does she not find it strange that in an essay on foreign affairs he never referred once to Labour's policy of withdrawal from the Common Market or the removal of nuclear weapons and bases? Does not she agree that it would be far better if the right hon. Gentleman came clean and renounced those policies, which he knows will be a complete disaster for Britain?

The Prime Minister: I agree that it would be a complete disaster to withdraw from Europe or to abandon our nuclear weapons. The former would have a devastating effect on British industry and the latter would mean that we were not properly able to defend ourselves.

I have not read the essay of the right hon. Member for Leeds, East (Mr. Healey). I do not follow these matters meticulously. But I do not share my hon. Friend's surprise. The right hon. Gentleman seems always to accommodate his views to those of the Labour party, whatever either may be.

Mr. Ashley: Does the Prime Minister agree that some of the saddest sights that we have seen in the past few days have been the enforced sale of the Victoria Cross by the widow of a second world war soldier and the requests by widows of men in earlier wars to visit the graves of those men? Will the Prime Minister consider initiating an urgent and wide-ranging review of the problems of widows of those wars so that they can be given the same kind of consideration, kindness and compassion as has been properly shown to the widows of soldiers in the Falklands campaign?

The Prime Minister: As the right hon. Gentleman will be aware, the Government's record in improving the lot of war widows has been unsurpassed by any other Government, including that which the right hon. Gentleman supported, both in terms of the special increases that we have given for old age and in that we have completely taken war widows out of taxation.

It is very sad that the Victoria Cross has been sold. We have looked into that case and Mrs. Nicholson was visited. She was awarded a war widow's pension after her husband's death in the last war, with an increase for her son. Later in life, her son's school fees were met under the war pension scheme. In addition to the standard war widow's pension she has had some help from the RAF

benevolent fund. She also has a rank allowance and an age allowance. We were not aware that she needed any further money.

I repeat that we have an excellent record on caring for war widows and I imagine that the excellence of that record will continue in future.

Q4. Mr. Adley asked the Prime Minister if she will list her official engagements for 28 April.

The Prime Minister: I refer my hon. Friend to the reply that I gave some moments ago.

Mr. Adley: Is my right hon. Friend aware that in two recent evenings' canvassing with the excellent Conservative candidates in the Grange ward of Christchurch, which has the largest council house estate in my constituency, I have come across a number of erstwhile Labour voters who have expressed their grave concern and disillusionment with the Labour party's policy of support for the CND? Therefore, will she do everything that she can to encourage comrade Kent and his Socialist cohorts to keep defence at the forefront of our political debate?

The Prime Minister: I agree with my hon. Friend. We shall indeed keep defence matters at the forefront of debate. They are vital to the security of our way of life and the British people. They are also vital to our international standing and I hope that there will soon be a full debate in the House on those matters.

Q5. Mr. Tom Clarke asked the Prime Minister if she will list her official engagements for Thursday 28 April.

The Prime Minister: I refer the hon. Gentleman to the reply that I gave some moments ago.

Mr. Clarke: Is the Prime Minister aware that there is widespread concern in Scotland about recent remarks of the Secretary of State for Defence? Is she aware that distinguished representatives of the Church of Scotland, the Episcopalian Church and the Catholic Church took grave exception to his smear upon the peace movement? Will the Prime Minister use her influence to encourage the right hon. Gentleman to raise the standard of this important debate to a level that it is entitled to expect?

The Prime Minister: With regard to the head of any church, my right hon. Friend has had no conversation with either Cardinal Hume or—[HON. MEMBERS: "Answer the question."] I am giving the facts. Just because the Labour party does not like them does not make them any less the facts.

My right hon. Friend has had no such conversations, either with Cardinal Hume or indeed the head of any other church or religious organisation. That answers the first part of the hon. Gentleman's question.

On my right hon. Friend's other revelations about the leaders of CND, I fail to see that anyone can be blamed for revealing the facts.

Mr. Maxwell-Hyslop: Does my right hon. Friend agree that the most unchallengeable credential for leading a peace movement is to have been responsible for carrying out policies that have preserved peace? In doing that, my right hon. Friend and the preceding five Prime Ministers, who have kept Britain in NATO with nuclear weapons defending that alliance—[AN HON. MEMBER: "What

26 April 1983

Policy Unit

PRIME MINISTER

E(LF) MEETING, 27 APRIL 1983

Unfortunately, I shall not be able to come to E(LF), as I promised a year ago to give a lecture tomorrow morning on my book to the Marriage Research Centre, and I don't think it would look right to cancel that.

At our meeting with Tom King and Terry Heiser, I think we were all impressed with the difficulties which a general limit on rate increases might involve - notably, the hundreds of applications for derogation and the protests from Conservative councillors. It's a pity, because a general limit would be more politically attractive.

However, if we reluctantly opt for a selective limit, it is worth thinking how we might present it. The present draft of the Manifesto on the question reads like this:

"We have also made sustained efforts to control expenditure by local government. These are now bearing fruit in all but a number of grossly extravagant Labour-controlled authorities. Manpower - down to its lowest level since [1977] - has been brought under control in Conservative authorities, many of whom are also saving very large sums of ratepayers' money by putting out to tender important jobs like refuse collection and building repairs, as well as construction. We are at last breaking down the "in-house mentality" which led councils into the delusion that every little job had to be carried out by local authority employees, however wasteful and costly the consequences.

"We shall introduce legislation to curb excessive and irresponsible rate increases by high-spending authorities. The new Audit Commission will also help to keep a firm check on expenditure. It is clear that the Metropolitan Councils and the Greater London Council are a wasteful and superfluous tier of government. We shall abolish them and

return their functions to the boroughs or, in the case of services which need to be administered over a wider area - such as education in inner London - to joint boards of borough representatives who are likely to be more interested in economy, since they have to find the money out of their own rates. We do not believe that gigantic organisations are likely to save money or to be responsive to the people they serve. Our aim is to make local government more local."

How does this seem to you?

L. S. ...

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FERDINAND MOUNT

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PRIME MINISTER

MS

LOCAL TAXATION

1. I have seen E(LF)(83)7, 8, 9 and 10 which I understand the Sub-Committee is to discuss on Wednesday.

2. On the interim scheme, I agree with the Environment Secretary that for constitutional reasons (his paragraph 3) and practical reasons (paragraph 4), including the impact on civil service manpower, we should reject a general system of control of rates underpinned by extra Exchequer grant. For much the same reasons, I have doubts even about the scheme which he puts forward in paragraph 15. We considered this very thoroughly in MISC 79 before Christmas, and most of us were convinced that, for a small and uncertain saving in public expenditure, it would seriously upset the balance of power between central and local government and call into question the statutory position of the Secretary of State for Education and some other Ministers.

3. In his paper the Chief Secretary invites us to commit ourselves at once to an interim scheme under which we would set a limit on the rate increase which any authority could make, but which would also allow individual authorities to seek derogations. In this way he would hope to catch only the small number of outrageous over-spenders. I sympathise with this intention, but I am not at all sure that we should be able to frame the legislation in such a way as to avoid a large number of applications for derogations, conflict between the responsibilities of the Environment Secretary and those of other Ministers and, in particular, a field day for the lawyers in a succession of difficult court cases. I think we need to be clearer about these issues before coming to a firm conclusion. It would be rash to promise more than we could deliver.

C O N F I D E N T I A L

4. On the final scheme, the EC problems over a local sales tax and the likely objections of many of our supporters in rural areas to a local tax on motoring are formidable obstacles, and I share the Chief Secretary's reservations about these new taxes.

5. This year the average increase in rates is much lower than in the recent past, despite the reduction in the level of grant. This is due both to our success in reducing inflation and to the block grant system which, in all but a handful of areas, has brought expenditure close to our plans. (The GLC and the ILEA alone account for more than half the prospective overspend in England this year, and we are considering the abolition of the former and the reform of the latter.)

6. I believe that the right way forward immediately is to undertake to improve the rating system, domestic and non-domestic, early in the next Parliament broadly on the lines indicated in paragraphs 27 and 28 of E(LF)(83)7 and to continue to exert the strongest possible pressure through block grant. At the same time we should ask officials to try to devise a selective scheme that avoids the difficulties to which I have referred in paragraph 3 above.

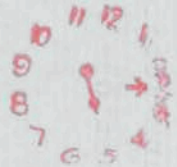
7. I am sending copies of this minute to the other members of E(LF) and to Sir Robert Armstrong.

KJ

26 April 1983

C O N F I D E N T I A L

26 APR 1963





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PRIME MINISTER

LOCAL TAXATION

I should like to comment briefly on the papers that are to be considered by E(LF) tomorrow.

2 To my mind the report by officials and Tom King's covering memorandum (E(LF)(83)7) bring out very starkly the serious problems and the undesirable consequences that would flow from direct and active central Government involvement in the control of local rates. The relationship between central and local government would be radically changed and for the worse in my view. Local accountability, which I regard as a cardinal principle, would be thoroughly undermined by the general schemes to freeze or limit rate increases examined by officials. A highly selective scheme of the kind preferred by Tom King would be less objectionable from this point of view, but it would not measure up to the size of the problem. A highly selective scheme would certainly not be regarded by industry as an adequate response to a situation which is causing widespread and serious concern. Like the Chief Secretary, therefore, I think a general measure bearing on all excessive rate increases is needed.

3 There is in my view an alternative approach which avoids the pitfalls of a control scheme operated by central Government and I am glad that Tom King has drawn attention to it in paragraph 13 of his memorandum. The essence of this approach would be to oblige local authorities which wish to exceed a predetermined limit of rate increase to seek the agreement of local electors, whether by means of a special election or a poll on the issue. There is no reason why this approach should be any less effective in deterring proposals for unacceptably high rate increases than the general scheme advocated by the Chief Secretary. The



predetermined limits could be as stringent. Local authorities would be no readier to seek a dispensation from their electorate than from central Government and probably no likelier to get it if they did.

4 Tom King is right to say that this approach is not free from difficulties either but I maintain they are a great deal less than with the control schemes. Moreover I am convinced that it would prove popular with ratepayers and that those of our supporters who were hostile in 1981 could be won over by public pressure and by being left in no doubt that the alternatives would be even less to their liking.

5 One of the difficulties referred to by Tom King is that this approach could not easily be reconciled with the final scheme. This would not arise of course if the final scheme is rejected, as in my view it should be.

6 I agree with George Younger and Leon Brittan that a new expenditure tax would be unpopular and difficult to implement and control. It would certainly not find favour with the business community. Both the LST and the RFD/VED options would impose new administrative burdens and significant compliance costs on businesses which would be particularly irksome for small firms. Colleagues will recall that the CBI, the Institute of Directors and most other industrial commentators on the 1981 Green Paper favoured reform of the existing rating system to the introduction of new local expenditure taxes.

7 Finally, I wish to signal my support for the other proposals listed in paragraph 30 of Tom King's memorandum amongst which I particularly welcome the proposal to remove entirely the burden of rates from empty industrial property. I am sorry we were not able to agree to make this change sooner so that the much-needed relief would have been available earlier in the recession.



Especially in view of the delay I am in no doubt that the half-way measure the Chief Secretary prefers would be regarded by industry as too little and too late.

8 I am copying this minute to other Members of E(LF) and to Sir Robert Armstrong.

PJ

P J

26 April 1983

Department of Industry
Ashdown House
123 Victoria Street

26 APR 1983

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PRIME MINISTER

Local Taxation:

E(LF)(83)7, 8, 9 and 10.

BACKGROUND

1. At its previous two meetings the Sub-Committee invited the Secretary of State for the Environment to arrange for officials to study a scheme of local finance under which increases in rates would be either prohibited or severely controlled but which would equip local authorities with a local tax on expenditure, perhaps in the form of a local sales tax, or some other 'safety valve'. To deal with the period before a new source of local revenue could be put in place, officials were also to study an interim scheme which would either freeze rates or strictly limit increases in them. The Sub-Committee accepted that this might entail an increase in the contribution of the Exchequer to local expenditure; and that the interim scheme (and indeed the long-term scheme) might have to include direct central control of current expenditure by individual local authorities (E(LF)(83)1st and 2nd Meetings).

2. The Interdepartmental Group on Local Taxation has carried out the studies required by the Sub-Committee. Its report is circulated with E(LF)(83)7, which sets out the views of the Secretary of State for the Environment.

3. The Secretary of State argues that any general scheme of control of the rates or expenditure of individual local authorities, such as those outlined by the interdepartmental group, would be impracticable. It would have to apply to all local authorities, except those to whom the Secretary of State gave a specific derogation. It would therefore carry a risk of legal challenge from a substantial proportion of the 500-odd local authorities in Great Britain. Instead, the Secretary of State recommends that the interim scheme should be based on selective control over the expenditure of a small number of the highest-spending authorities: the disciplines of the block



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grant system and 'holdback' would be relied on to contain rate increases by the generality of local authorities within a tolerable level. (By implication, the Secretary of State endorses the judgement of the inter-departmental group that a limit on rate increases is preferable to a rate freeze).

4. For the final scheme, the Secretary of State recommends a permanent ceiling on rates, applying to all local authorities. This requires that an additional source of local revenue should be found: the Secretary of State, in effect, offers a choice between local sales tax (LST) in the form of a single-stage tax with coverage and certain other features based on value added tax (VAT), and a combination of a vehicle excise duty (VED) and road fuel duty (RFD). He suggests that the Government should put forward both possibilities in a consultative document. The final scheme would also include the selective control over the expenditure of the highest-spending authorities recommended for the interim scheme. It would take effect from 1988.

5. E(LF)(83)7 also proposes that the package of relatively minor reforms in the rating system recommended by the Ministerial Group on Local Government Organisation and Finance (MISC 79) should be adopted; and that the burden of rates should be removed from empty industrial property. It discusses the problem of devising a new system of Exchequer grant for a situation in which local authorities have more than one source of tax revenue but does not advance definite proposals.

flag D + flag E
6. The Secretaries of State for Scotland (E(LF)(83)10) and Wales (E(LF)(83)8) agree that there should be no general scheme to limit the rates. Both draw attention to the success of the Government's existing policies in limiting rate increases (and there is similar material in Annex C to the report of the interdepartmental group). Both support the introduction of a selective scheme of control, although the Secretary of State for Wales suggests that even this may be unnecessary in Wales; the Secretary of State for Scotland, who already has selective powers of control, proposes to take general hold-back powers, so as to match the English position.



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7. For the longer term, both Secretaries of State draw attention to the disadvantages of a scheme based on RFD and VED. They also express scepticism about the acceptability of LST; but the Secretary of State for Scotland explicitly agrees that it should be put forward for public consultation, and the Secretary of State for Wales does not object.

8. Finally, the Secretary of State for Scotland proposes some reforms of the Scottish rating system and indicates that he intends to pursue separately some possible changes in Unified Housing Benefit.

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9. The Chief Secretary, Treasury (E(LF)(83)9) argues for a general, rather than a selective, scheme of limitation on rate increases. For the longer term he doubts the need for a supplementary local tax, though agreeing that the Government should put the possibility forward in public consultation. The amount of any supplementary tax should be limited by central government. On a point of relative detail, he suggests that instead of abolishing rates on empty industrial property, the Government should limit the maximum to 25 per cent of the full rate.

MAIN ISSUES

10. It will not be possible to deal with all the issues raised by the report of the interdepartmental group; and you will wish to ensure that the Sub-Committee concentrates on the main questions of principle. These are as follows.

For the interim scheme

(i) If there is to be an interim scheme should it

- be selective or general?

- be based on a rate freeze or a limitation of rate increases?

(ii) Do the benefits of the interim scheme outweigh its advantages?

(iii) If not, is there a preferable alternative?



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For the longer term

(iv) Are Ministers willing to confer on local authorities one or more of the supplementary taxes discussed by the inter-departmental group? If so, do they regard one form of supplementary taxation as clearly preferable? Or would they prefer to leave the decision to follow a further round of public consultations?

(v) How should the Government's position be publicly presented?

(vi) Should the longer term scheme include a limit on the expenditure or taxation of individual local authorities?

Finally, the Sub-Committee will need to consider:

(vii) Should the reforms in the rating system recommended by MISC 79 be endorsed for legislation in the 1983-84 Session?

(viii) Should empty industrial property be exempted from rates?

Interim Scheme

11. In considering the options for a scheme of control of rates or expenditure, the most important criterion is the likely workload. It will simply not be possible to run a scheme in which dozens of disputes have to be fought out - ultimately in the courts - between individual local authorities and Ministers. There are over 500 local authorities in Great Britain. Of course, not all would object to Ministerial decisions under a control scheme; and not all objections would be fought to a finish. You will wish the Sub-Committee to explore this aspect carefully. But at the least it seems



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clear that any general scheme of control will have to lie fairly lightly on the average local authority.

12. This has the important implication that either permissible rate increases under the scheme or Exchequer grant to local authorities would have to be set fairly high: otherwise too many authorities would ask for derogations. The consequence could well be higher local expenditure than under a severe block grant and holdback scheme (perhaps coupled with selective control of particularly high-spending authorities). In the long run, lower expenditure should lead to lower rates. But, under the holdback scheme, this may well be achieved by grant penalties and therefore, in the short run, higher rates. Ministers may therefore face a choice between -

(a) a general scheme to keep down rates if their prime aim is to minimise rate increases in the short run; and

(b) reliance on block grant and holdback (perhaps coupled with a selective scheme of control for a few authorities) if their prime aim is to keep down expenditure (which should also keep down rates, eventually, but not necessarily in the short term).

A selective or a general scheme?

13. These considerations are clearly relevant to the choice between a selective and a general scheme. A selective scheme would allow the Government largely to determine its workload; and it is a fact that the bulk of local authority over spending is attributable to a small number of authorities. Moreover, by focusing on a small number of authorities who can reasonably be represented as behaving outrageously, it minimises the political difficulties of central government taking general powers to control the expenditure or rates of individual local authorities. On the other hand it may be argued that the Government is making a major contribution to dealing with the exceptionally high spenders by abolishing the GLC and metropolitan counties. Is a selective scheme of control necessary as well? It may also be argued that a selective scheme is of little relevance to the general problem of rate increases. Many authorities may impose increases in rates that are high, but not so



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unreasonably high as to justify intervention by the Government. In such cases, the Government will have to rely on arguments based on its success in controlling inflation and its construction of a grant and holdback system deterring excess of expenditure in order to rebut criticisms that it is doing too little to keep the rates down.

A freeze on rates or limitations of increases?

14. A scheme based on a freeze of the rates would multiply applications for derogation and require substantial increases in national taxation. For both these reasons it is unlikely to find favour with the Sub-Committee. You will recall that opinion in the Sub-Committee was already tending strongly in that direction at the last meeting; and all four papers for the present meeting are based on limiting rate increases.

The merits of an interim scheme?

15. Whatever its form, any control system seems likely to have to feature default powers (so that the Government can, in the last resort, take over essential services in defaulting local authorities). There are also the arguments based on 'service policies' (paragraph 4(iii) of the note by the Chairman of the Interdepartmental Group) and the problems of reconciling the responsibilities of Ministers responsible for local government services in England with the fact that, for operational reasons, decisions under any control scheme would have to rest with the Secretary of State for the Environment. The Sub-Committee will wish to consider whether these difficulties outweigh the advantages of whatever control scheme it may favour.

Possible alternatives

16. If the Sub-Committee does not favour any scheme of direct control of the expenditure or rates of individual local authorities, you will wish it to consider possible alternatives. Paragraphs 13 to 15 of E(LF)(83)7 discuss the possibility of requiring authorities wishing to levy what the Government regards as excessive rates to hold a referendum or special election. The recent history of this idea is not encouraging; but it could be argued that it would have more attractions if it were carefully presented.

17. An important difficulty with such ideas is that if those who vote are not the same, or nearly the same, as those who pay local taxation,



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referenda or special elections do not meet the point that it is unfair that people should be able to vote for policies towards whose cost they do not contribute. On the other hand, if they are the same, the normal process of accountability through elections should suffice at local, just as it does at national, level.

The longer-term scheme.

18. The essential feature of the longer-term scheme is that it would contain a general limitation on rate increases. This requires that local authorities should have some alternative source of revenue to rates. (The only other possibility is a permanent system of deficit grant from the Exchequer, which hardly seems acceptable). Ministers cannot therefore promise a general limitation on the rates unless they are confident that some form of supplementary local taxation will be acceptable.

Which supplementary tax?

19. The arguments in the papers for rejecting possibilities other than LST, RFD and VED seem persuasive; and the arguments relating to those three taxes are also clearly set out. There are, however, a few additional points which you may wish the Sub-Committee to consider.

(a) Road fuel duty

High local rates of RFD will easily be avoided in metropolitan areas, but not in rural areas. The Government would therefore be attacked on the one hand for pretending to be prepared to allow local authorities the power of decision (at least within limits) over their expenditure while conferring on them a tax which in practice will prevent their using that power; and, on the other, for exposing some sections of the community to heavy taxation on what is a virtual necessity of life. It will also be argued strongly that RFD is, in many areas, completely unrelated to residence; and in all areas is unrelated to either use of local services or income (two of the main criticisms of the rates).

(b) Local sales tax

Somewhat similar arguments could be advanced against LST, but



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to a much lesser extent. On the other hand, it would be argued that those least able to avoid heavy local sales taxes are the old and the immobile.

(c) Vehicle excise duty

If Ministers favour using road taxation as a source of local revenue, there may be more to be said for using VED than RFD, since it would at least be levied on the basis of residence. The interdepartmental group did not regard VED as adequate by itself because they regarded themselves as bound to assume severe restrictions on both rate increases (in fact, a rate freeze for several years) and Exchequer grant. If Ministers were prepared to relax these assumptions, VED by itself might be an adequate source of local taxation to support the rates. There would remain the problem that, in so far as VED (yielding £1½ billion a year) is used to relieve the rates, an alternative source of revenue has to be found for central government.

Implications for Exchequer Grant

20. Although the Sub-Committee does not need to take any decisions in this area, it should be aware that, as paragraphs 25 and 26 of E(LF)(83)7 point out, the introduction of an additional form of local taxation will lead to serious complications in the system of Exchequer grant. The technical problems should be soluble. But -

(a) the existing RSG system is already widely criticised as too complicated to be understood; a new system will be still more complicated;

(b) equalisation of resources under the present system already rests on the shaky foundation of an outdated valuation of domestic property. It may be impossible to defend basing a completely new system on this valuation. The upshot could be a full revaluation of domestic property, which Ministers have so far wished to avoid.

21. In short, the need to devise a new system of Exchequer grant would lead to a good deal of public criticism; and this would be bound to rub off on to the other features of whatever the Government may propose.

Public presentation of the options

22. If Ministers favour either or both of RFD and VED as the supplementary tax, it will be natural to put forward a proposal to that effect in either a White or a Green Paper. If they favour LST, it would probably be prudent to present both it and RFD/VED as options in case consultation with the European Commission should suggest that LST would be likely to be struck down by the European Court. If Ministers agree that the Government should advocate giving local authorities a new form of tax but have no clear preference for a particular tax, the options would be put forward for public discussion.

23. The papers before the Sub-Committee, however, suggest that Ministers might prefer to avoid proposing new forms of local taxation. The Sub-Committee will need to consider the alternative approach, indicated in the papers, under which the Government would canvass the possibility of a general limitation on rates, point out that such a limitation inevitably implies the creation of a supplementary form of local taxation, and set out the options. If the ensuing public debate suggested that most people would prefer to stick with the rates as the sole form of taxation, even though no general scheme of rate limitation would then be possible, the Government would be free to accept that judgement.

24. Such an approach would need careful presentation. The local taxes being considered by the Sub-Committee have secured little public support in earlier consultations. There is a danger that if the Government were to put forward one or more of them as its preferred option it would be accused of making proposals which it knew would be rejected in order to escape from its previous pledges on the rates. It would be necessary, in particular, to explain why local income tax was not acceptable. It might also be helpful to point out that the Government was considering supplementing, not replacing, domestic rates; and that for that reason some of the objections previously seen, for example, to local sales tax no longer applied.

A permanent control scheme?

25. If Ministers favour including in the interim scheme a general system of control of rates or expenditure, it would be logical to continue it


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into the longer term scheme, with whatever modifications may be needed to take account of any supplementary form of local taxation: it would be hard to justify all the political and other difficulties that such a scheme would entail if it was to last for only three or four years. As the Chief Secretary points out, it would be logical to extend a control scheme to cover any new form of local taxation.

26. If, on the other hand, Ministers favour a selective system of control for the interim scheme, it would be illogical for the long term scheme to include a general system of control; and the question is whether the selective system of control should be made permanent. Since it would probably have to be justified initially by reference to the need to control local authority expenditure and taxation in general, rather than the rates alone, it would seem more natural to make it a feature of the long term system, as recommended in E(LF)(83)7.

Minor reforms in the rating system

27. The recommendations at (ii) to (vi) of paragraph 30 of E(LF)(83)7 repeat the recommendations of MISC 79. The only one which may be contentious is the proposed discount scheme for single-person households; and you may wish the Sub-Committee to discuss this.

28. The detailed proposals in paragraphs 13 and 14 of E(LF)(83)10 should be capable of being resolved between the Secretaries of State for Scotland and the Environment and the Chief Secretary; the Secretary of State for Scotland is not seeking a decision at this stage on the matters discussed in paragraph 15 of his memorandum.

Rating of empty industrial property

29. Again this is an issue which can probably be resolved outside the Sub-Committee by the Secretaries of State for Scotland, Wales and the Environment and the Chief Secretary. You will, however, recall that when the subject has been discussed before it has been suggested that complete exemption from rates of empty industrial property would diminish the incentive to keep it in lettable condition.

Future action

30. The papers cover such a wide range of difficult issues that it is



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impossible to be certain how any further work will best be handled. But if the Sub-Committee is broadly content with the proposals in E(LF)(83)7, and subject to any particular points that may need to be further explored, it will probably be appropriate to invite the Secretary of State for the Environment (perhaps in conjunction with the Secretaries of State for Scotland and Wales) to submit proposals to the Cabinet for approval.

HANDLING

31. It will be convenient to divide the discussion into two main parts:

- (i) The interim scheme; and
- (ii) the long-term scheme.

On each, you might ask the Secretary of State for the Environment to open the discussion; the Secretaries of State for Scotland and Wales could then be asked to speak and, in particular, to make any Scottish or Welsh points. The Chief Secretary, Treasury will wish to comment, both from the standpoint of control of public expenditure and on the tax options. All other members of the Sub-Committee are likely to wish to contribute. The Attorney General will be able to advise on the risks of legal challenge under any control system.

CONCLUSIONS

32. You will wish the Sub-Committee to reach conclusions on the following.

- (i) Should there be an interim scheme to control rates or current expenditure of individual local authorities? If so, should it be -
 - (a) selective or general;
 - (b) based on a rate freeze or a limitation on rate increases?



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(ii) If not, should there be some alternative, such as a requirement for a local authority wishing to rate above a prescribed figure to hold a referendum or a special election?

(iii) For the longer term, are Ministers willing to propose that local authorities should be empowered to raise revenue from one or more of the following sources:

- local sales tax;
- road fuel duty;
- vehicle excise duty?

(iv) If so, do they regard one or more of these possibilities as so clearly preferable that it (or they) should be put forward as the Government's preferred option? Or would it be better to consult on the basis of an open choice?

(v) Alternatively, do Ministers regard the difficulties of the possible new sources of local taxation as sufficiently serious to make it inadvisable to put them forward in public as favoured by the Government? If so, would they wish -

(a) to rely on an extension of the interim scheme of control; or

(b) to canvass the possibility of new sources of local taxation coupled with a general limitation on rates, but without positively advocating it?

(vi) Should the package of minor reforms of the rating system recommended in paragraph 30(ii) to (vi) of E(LF)(83)7, be endorsed with a view to legislation in the 1983-84 Session?

Depending on the course of the discussion you will also wish the Sub-Committee to give guidance for the handling of future work.



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33. Finally, it may be appropriate to record conclusions relating to:

(vii) the minor proposals in paragraphs 13 and 14 of E(LF)(83)10; and

(viii) rates on empty industrial property.

But you will probably prefer to invite the Ministers concerned to resolve the issues outside the Sub-Committee.

PL

P L GREGSON
Cabinet Office.
26 April 1983



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CFM

P.01001

Prime Minister

MR SCHOLAR

*This is an aide-memoire
for your 'semi-tutorial' on*

LOCAL TAXATION

*Monday with Mr King, Mr Heiser
& Lord Bellwin. MCS 22/4*

We shall be letting the Prime Minister have a brief for E(LF) on Wednesday 27 April in the usual way. I promised however to let you have a short minute to bring out the main issues, to assist the Prime Minister with her briefing meeting with Mr King and Mr Heiser on Monday and to give some perspective to the papers which the Prime Minister will be reading over the weekend.

2. Decisions are required on:

i. The interim scheme, ie measures (resulting from legislation in the first session of the new Parliament) which would affect rates from 1 April 1985 onwards.

ii. The long term scheme, ie measures which could affect rates from 1988 onwards (this being the earliest possible date for a viable supplementary local tax or taxes).

Interim scheme

3. In relation to the interim scheme, the broad choices are as follows:

i. A general control scheme, ie a scheme to limit rate increases by all local authorities with scope for derogations on a discretionary basis.

ii. A selective rate control scheme, ie a scheme under which the Secretary of State would single out for control a small number of high spending authorities.

iii. A scheme for control by special elections, ie a scheme requiring high rating and spending authorities to hold a special election before they can levy the top slice of their prospective rate demand.

iv. No change, ie using block grant and holdback schemes to restrain local authority expenditure.

All these variants can be combined with a package of minor reforms such as those favoured by MISC 79 (eg the discount for single person households and other measures listed by Mr King in paragraph 30 of E(LF)(83)7).

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4. The Chief Secretary favours option i, the general control scheme. It has the advantage that the Government could say that it would be limiting rate increases generally. The officials' report makes it clear that a general control scheme would be technically feasible. The question is whether it would prove in practice to be administratively and politically workable. It seems clear that it would work only if the Government was not too ambitious in its aspirations. The limit on rate increases would have to be realistic to keep down the number of requests for special treatment and requests for such treatment would have to be dealt with sympathetically.

5. Option ii, the selective control scheme, is favoured by Mr King because he does not believe that a general control scheme would be workable. He envisages applying control to only "a limited number of high spending and/or rating authorities". It would be useful to know how many such authorities he envisages. It should be borne in mind that if and when the GLC and Metropolitan Counties are abolished, and their functions transferred to the lower tier, the number of high spending and rating authorities (though not their geographical coverage) could actually increase. Moreover, the Attorney General has advised that a selective control scheme is marginally more exposed to the risk of legal challenge than a general scheme. There is also the difficulty that, in going for a selective scheme, the Government would be unable to claim to be limiting rate increases generally.

6. Option iii, control by special elections, did not find much favour with Ministers collectively in the autumn of 1981 and the referendum variant of this option raised strong Parliamentary opposition. The Prime Minister would need to be sure that there are good reasons why this option should prove more acceptable in the future.

7. Option iv is unattractive politically. The Secretary of State for Scotland favours this approach and it is arguable that the best way to control rates in the longer term is through controlling expenditure, and that the Government's efforts in that direction are now beginning to bear fruit. But the Government would need to be sure that this line of argument could be carried with the electorate and that the package of minor reforms would be seen as an adequate response.

Long term scheme

8. The options for the long term are broadly:

- i. To continue as in the interim scheme.



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ii. To combine the control scheme adopted in the interim with new supplementary local taxation, thus permitting tighter restraint on rates or even a ceiling on rates at their 1988 level.

iii. Consulting publicly on a neutral basis about i. and ii.

9. The papers demonstrate the very real problems involved in introducing even the most promising supplementary local taxes, ie Local Sales Tax (LST) or a combination of Vehicle Excise Duty (VED) and Road Fuel Duty (RFD). The Chief Secretary is not convinced that there is a need for supplementary local taxes and he would like the Government to avoid commitment to any new local taxes until there has been time to judge whether a general rate control scheme is sufficiently effective.

10. The Government will not want to commit itself to a ceiling on rates in the longer term unless it is sufficiently satisfied that one of the possible new supplementary local taxes is both feasible and politically acceptable. If the Government is not satisfied about this, the choice is between option i. (ie promising nothing extra for the long term) and option iii. (consulting on a neutral basis so that if there is public opposition to LST and RFD/VED the case for keeping the rates (subject to some control scheme) would be more defensible).

PLG

P L GREGSON

22 April 1983

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INTERDEPARTMENTAL GROUP ON LOCAL TAXATION

REPORT ON RATES CONTROL AND
LOCAL SUPPLEMENTARY TAXES ON
EXPENDITURE

APRIL 1983

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REPORT OF THE INTERDEPARTMENTAL GROUP ON LOCAL TAXATION

APRIL 1983

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REPORT OF THE INTERDEPARTMENTAL GROUP ON LOCAL TAXATION

CHAIRMAN'S NOTE

1. I attach the report of the Interdepartmental Group on Local Taxation, which was established by the Secretary of State for the Environment following discussions in E(LF) on 16 February and 14 March. The Group was asked to report on:

- (i) an interim scheme designed to achieve a freeze on domestic rates or a strict limitation on rate increases, with any necessary increase in the Exchequer contribution by Rate Support Grant (RSG) or otherwise; followed by -
- (ii) a final scheme based on a permanent ceiling on rates, coupled with a new supplementary tax or taxes on expenditure, and perhaps a continued control over either expenditure or the maximum level of local taxation.

2. The Group have interpreted the first part of this remit as applying to both domestic and non-domestic rates, since if domestic rates alone were controlled local authorities would be able to make good any loss of income through unlimited increases in non-domestic rates.

3. This note deals with the main issues in relation to (A) interim scheme; (B) final scheme; (C) other matters; and (D) legislative and consultative timetable. Except where stated otherwise, the note refers to Great Britain. Internal paragraph references are to the main report.

A. INTERIM SCHEME

4. The Group believe that Ministers may wish to weigh the potential benefits of any control scheme against the following considerations:

- (i) Legal Risk. There are 523 local authorities in Great Britain, responsible for a wide range of services. To be equitable and practicable any scheme for controlling rates would need to be based on

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general rules. But there are such differences in local circumstances that the general rules would have to be subject to exceptions ie "derogations". The Attorney General has advised that legislation would need to confer on the territorial Secretary of State authority for deciding whether a given level of expenditure should be permitted. He would be entitled to consult other Ministers, but the final decision would be his alone. There would be a risk of successful legal challenge on the grounds that the Secretary of State had behaved 'unreasonably'. The greater the number of applications, the greater the risk (paragraphs 70 and 72).

- (ii) Default. Under any control scheme some authorities might seek to make the system unworkable by ceasing to provide services or through financial irresponsibility (paragraph 92).
- (iii) Service policies. A control scheme would have implications for Government policies for the 'national' local government services, including the police and education, since their successful implementation depends on local authority co-operation. It would also be necessary to reconcile guidance with expenditure implications given by service Ministers and decisions on derogations (paragraphs 62-65).

Choice of Scheme

5. Any control system has to take account of the fact that the net expenditure of a local authority equals rate income plus grant. If any two of these are controlled directly, the third will also be controlled consequentially. There are thus three basic models for a control scheme: A, in which expenditure and rates are directly controlled; B, in which rates and grant are directly controlled; and C in which expenditure and grant are directly controlled. Within these models the Group identified two types of scheme for freezing rates and three types of scheme for limiting rate increases in England and Wales; under all schemes the currency of calculating rate limits should be rate poundages (paragraphs 22-49):

Rate freeze schemes

A(i) - suspend present grant systems and pay deficit grant to each local authority equivalent to the difference between rate income and expenditure

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on a 'reasonable budget' defined by Government. The aggregate of 'reasonable budgets' would relate to the centrally planned total of local government expenditure.

B(i) - maintain present grant systems; each authority's permitted expenditure defined by its grant entitlement and its frozen rate poundage. There would be no 'reasonable budgets' defined in advance by Government, but the underlying expenditure assumptions used for calculating grant distribution would relate to the planned total of local government expenditure.

Rate increase limitation schemes

A(ii) - As A(i) but maximum permitted rate increases specified nationally or for classes of authority instead of a rate freeze.

B(ii) - As B(i) but constrained by maximum permitted rate increases specified nationally or for classes of authority instead of a rate freeze.

C - maintain present grant systems; each authority given a "reasonable budget"; there would be no explicit specified maximum rate increase as in A(ii) or B(ii). The maximum rate for each authority would be the rate required to bridge the gap between an authority's "reasonable budget" and its grant entitlement. This could result in permitted rate increases or decreases. There would be an implicit national average rate increase derived from the grant total and the aggregate of "reasonable budgets".

6. It would be possible to vary the detail of these illustrative schemes. Schemes broadly similar to A and B can be developed for Scotland but the Scottish equivalent of Scheme C would be different because of basic differences in the grant systems (paragraph 116).

7. If Ministers decide to proceed with a control scheme the main questions are (i) whether there should be a rates freeze scheme or a rate increase limitation and (ii) which of the schemes to choose. Any scheme would need legislation but could be implemented as from April 1985.

Rate freeze or rate increase limitation

8. A freeze on rates would be simpler and more welcome to ratepayers than a control of rate increases. But schemes of this kind (A(i) and B(i)) would require more Exchequer grant to finance any given level of expenditure, both because rate income would be severely restricted and also to meet the cost of successful applications for derogation. There would be larger numbers of applications for derogations, since authorities would not have to bear any of the cost if extra expenditure were permitted, and the risk of successful legal challenge would therefore be higher. For these reasons the Group consider therefore that a rate increase limitation scheme would be preferable to a rate freeze scheme (paragraph 138.)

Rate freeze schemes

9. Scheme A(i) would be simpler and more comprehensible than Scheme B(i), but the longer it ran, the more turbulence there would be in restoring an equalising grant. The larger part of block grant - a total of about £4.2bn out of £8.6bn in England in 1982/83 - is distributed so as to compensate differences in changing spending needs and rateable resources between authorities, enabling authorities in the same class to charge their ratepayers the same poundage for providing the same standard of service. Without this compensation, relative rate burdens across the country would be very different (paragraphs 12-13 and 32-33).

Rate increase limitation schemes

10. The choice between schemes A(ii), B(ii) and C turns on the weight given to the desirability of relating rate increases in 1985/86 as closely as possible to actual rate levels in a previous year, and the case for preserving an equalising grant. Schemes A(ii) and B(ii) come closer to relating rate increases to actual rate levels in 1983/84 than Scheme C; Schemes B(ii) and C preserve the equalising grant, unlike Scheme A(ii). More anomalies are likely to be created between individual authorities under Scheme B(ii) than Scheme C, which would match changes in rates more exactly to expenditure needs (paragraphs 33-34).

Other issues

11. The Group's views on the more important of the other issues raised are as follows:

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- (i) Rate levels. The base year for calculating rate limits should be 1983/84, the year before the interim scheme could start, to avoid validating high rate increases in 1984/85. Rate levels could be allowed to fluctuate beneath the rate limit to encourage authorities to reduce rates wherever possible (paragraphs 28-30).
- (ii) Lower tier precepts. Precepts by lower tier authorities (eg parish councils) should be included in the rate limits of the rating authority, but further consideration needs to be given to some direct constraint on the maximum level of such precepts (paragraphs 42-43).
- (iii) Parliamentary authority for derogation. It would be impracticable for Parliamentary approval to be sought for every derogation. The territorial Secretary of State should therefore have power of decision on derogations subject only to judicial review (paragraphs 60-61).
- (iv) Legal challenge. The risk of legal challenge could be reduced - although it cannot be eliminated - by providing 'headroom' in the initial permitted levels of expenditure, grant and rates, by use of balances, fees, rents and charges as 'safety valves'; and in England by consultation between the territorial Secretary of State and service Ministers where appropriate before decisions on derogations are taken (paragraphs 73-78 and 64-65).
- (v) Interdepartmental review. There should be an interdepartmental review of advice and guidance given by service Ministers to local authorities to reconcile such guidance with a control scheme (paragraph 63).
- (vi) Default. There should be legislative provision for the appointment of Commissioners if an authority refuses to observe the control provisions (paragraph 95).

12. Ministers may wish to take decisions in principle on the choice of scheme and the other issues set out in the preceding paragraph by the time any consultation document is published. There are a number of further issues which would also need to be settled subsequently and before a Bill were introduced (paragraph 140-142).

Public expenditure

13. The reasonable budgets and the rate limits in the control scheme would have to be achievable in order to minimise the number of applications for derogation and the risk of successful legal challenge. The effective public expenditure provision would therefore have to take full account of the actual level of aggregate expenditure in the financial year preceding the introduction of a control scheme. Furthermore, it would also be necessary to allow some financial 'headroom' (see paragraphs 11(iv) above) in order to minimise the number of applications for derogation. It is not therefore certain that a control scheme would produce a more effective constraint on local government expenditure than if the present grant systems were applied with maximum rigour. However the grant systems alone cannot eliminate rate increases or constrain them to the same extent as a rate control scheme (paragraph 84).

Manpower

14. The Group could find no precedent for calculating the manpower requirement of a control scheme. They have assumed that if Ministers choose a scheme which permits a modest average increase in rates, and no significant increase in the rate of grant, then there would be no more than about 200 applications a year. On this basis there might be a need for over 100 experienced and qualified professional and administrative staff in the territorial and other Whitehall Departments at the peak period for dealing with derogation applications between September and April, and for perhaps 300-500 similar staff in local government. There would be additional demands on the time of Ministers and elected members (paragraphs 99-101).

B. FINAL SCHEME

Main Options

15. Given the estimates of yield required (paragraph 152), the Group have identified two main options for a supplementary tax; either local sales tax (LST) or a combination of local road fuel duty (RFD) and local vehicle excise duty (VED). Customs and Excise and the Department of Transport respectively advise that LST and VED cannot be brought in as local taxes until April 1988 because of computer problems (paragraphs 180 and 215). RFD could however be introduced in

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April 1986 and might produce sufficient additional revenue to function as a single supplementary tax until VED could be introduced. Other options, such as RFD plus local duties on alcohol and tobacco, seem to involve collection and compliance costs disproportionate to their likely yield (paragraph 151).

A supplementary tax for both tiers

16. If there were to be rates ceilings for all local authorities, it would be necessary for each main tier to have access to the supplementary tax.

17. The Group have concluded that the most satisfactory arrangement would be to allow each county and district authority to levy its own rate of supplementary tax, and to retain its own yield. This would require a separate tax base to be defined for each authority, and could result in a wide range of tax rates within as well as between each county area. The extent of such variations is impossible to predict, but in so far as they occurred they would encourage cross-border shopping and distort the natural patterns of trade; although over time supplementary tax rates would probably converge to some extent. Differences between authorities in the yield of the supplementary tax could be compensated through the grant system (paragraphs 153-166).

Local Sales Tax

18. The Law Officers have advised that an LST appears to be compatible with EC requirements, but that it would be advisable to consult the Commission before taking a firm decision to proceed with LST, in order to minimise the risk of an adverse judgment from the European Court after the tax had been introduced. (paragraph 170).

19. The Green Paper identified two possible models for LST: one in which the coverage is established by national rules, and the tax is collected by Customs and Excise; the other in which the local authorities collect and administer the tax, possibly with the power to determine which goods and services should be taxable. The Green Paper favoured the former, and so do the Group. (paragraph 171).

20. The coverage of the tax would need to be decided; the Group consider that it should be collected on the same range of goods and services as VAT and that it

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should extend to certain business purchases as well as to retail transactions since business as well as domestic ratepayers would be benefiting from the limits on property rates (paragraph 172).

21. An important issue is whether the tax should be levied in steps of less than 1%. This might create operational problems for traders, but there could be a case for allowing steps of 0.1%, since a 1% change in the rate of the tax would produce a very large change in the yield, thus creating serious budgetary problems for local government and tending to produce surplus revenue. There would also be major problems in operating an equitable grant system unless the tax could be varied in steps of less than 1% (paragraph 189).

22. Central Government - primarily Customs and Excise - would need 2000 to 3000 extra staff to collect the tax. Increases in staff of perhaps several hundred would also be needed in local government. The total annual administrative cost - which would be recovered from local government - might be about £40m to £60m at 1982-83 prices, in addition to the present costs of rate collection of £156m (paragraph 181).

Road Fuel Duty and Vehicle Excise Duty

23. A supplementary RFD on petrol and derv could produce a yield large enough to finance local government expenditure into the early 1990's, after rates ceilings had been introduced, if inflation remained low (paragraph 195). A supplementary RFD could be introduced in 1986, if legislation were enacted by summer 1985 (paragraph 199).

24. The duty would have to be collected by each tier of local government or by one tier acting on behalf of the other, from about 25,000 petrol stations and perhaps as many more distributors and contract customers for derv (paragraph 192).

25. Local authorities might need at least 500 to 1000 extra staff - more if RFD were collected as well as levied by districts. The total administration costs might be in the range £10m to £15m per annum at 1982/83 prices (see paragraph 200).

26. It would be possible to transfer from April 1988 to local authorities the present national VED on cars, motorcycles, and light vans (VED on cars is

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currently £85). (The Group have assumed that the Government would wish to retain the VED on lorries, since it is an instrument of national transport policy). Both tiers of local authority would then set their own rate of VED; the Driver and Vehicle Licensing Centre would collect it and distribute it to authorities according to the place of registration of the vehicle (paragraph 209).

27. Central Government might need an extra 120 permanent and 100 temporary staff and local government an extra 1000, at an estimated total additional cost of £10m to £15m at 1982/83 prices (paragraph 216).

28. The Group have reached provisional conclusions on the detailed operation of both LST and RFD plus VED. Detailed proposals could be made the subject of consultation (paragraphs 190, 207 and 221).

29. If both taxes were to be treated as a package, they could be introduced simultaneously in 1988. If RFD were introduced earlier, VED could follow either in 1988 or at a later date, depending on the yield produced by RFD and that required as a result of the freeze on rates.

The supplementary taxes compared

(i) Yield

30. The yield required of a supplementary tax would depend primarily on a) the level at which rates were frozen, b) the rate of increase of local authority expenditure in cash, (which depends on the rate of inflation) and c) the level of Exchequer grant. On a central set of assumptions the yield required by 1993/94 might be about £4bn at 1983/84 prices (paragraph 152). This could be produced by an LST of 2% to 3% (in addition to the national rate of VAT), or by a combination of VED at its present level in real terms (ie £85 on cars, plus an allowance for inflation) together with a supplementary RFD of 30p to 40p a gallon in 1983/84 prices, on top of the present national RFD of 74p a gallon. It would be possible to defer the transfer of VED until the early 1990's, if higher rates of supplementary RFD than would otherwise be the case were acceptable. The transfer of VED would require a corresponding increase in national taxation (perhaps 2p on the basic rate of income tax or 2½% on VAT) if Exchequer revenues were to be maintained. On the same set of assumptions rates would continue to provide the main source of local authority income for many years. If however inflation proved to be high, the supplementary tax yield required would rise sharply (paragraph 152).

(ii) Gainers and losers

31. There are about 20 million domestic ratepayers. By comparison, LST would fall on about 40 million adults, plus a substantial number of children. The number of people paying RFD and VED cannot be precisely assessed, but is probably fewer than 20 million. The broad effect of both options would be to transfer a small part of the total tax burden from non-domestic ratepayers to private households. Either supplementary tax might lead to a very small increase in the Retail Price Index (RPI).

32. A preliminary assessment suggests that, given assumed consequential changes in national taxes, under both options more households would lose than would gain; the losses would be largest for those in receipt of supplementary benefit, whose rates are now paid for them. But under both options over 90% of households would probably find that the change in their personal disposal income was in the range of plus or minus 1½% if the supplementary tax were levied at a modest initial rate. In the case of RFD and VED the direct impact would be confined to motorists.

33. LST would tend to shift some of the tax burden from London to the rest of the country. RFD plus VED might bear more heavily on remote rural areas than elsewhere. There would be no bias against rural as compared with urban areas in general. These two taxes, however, might be perceived as inequitable in the rural areas, including most of Scotland and Wales. Shifts in the tax burden might be counter-acted through the grant system, provided that an equalising grant system were maintained (paragraph 230(a)).

(iii) General

34. There are some features which are common to both LST and RFD plus VED. They would create problems of cross-border shopping for traders; their yield would be less predictable than that of rates; they could lead to a multiplicity of local tax rates; LST and RFD would be less perceptible than rates (this would be less true of VED); they would lead to some loss of Exchequer revenue, remove VED from national taxation and constrain the Chancellor's freedom to change the rate of VAT and national RFD for purposes of fiscal management. As noted above, LST carries with it the uncertainty about compliance with EC requirements. The gross

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manpower and administrative costs of LST may be rather comparable to RFD/VED but rather higher than the net additional public sector costs of this combination (paragraph 230(h)). A tabular comparison of the two options is annexed to this note.

Frozen rates in the final scheme

35. The Group consider that the final rate ceilings would need to take account of the levels reached in the final year of the interim scheme; it might be necessary to make special adjustments in the light of representations from individual authorities. If rates were allowed to be varied both downwards and upwards, provided they were kept within the ceiling they could then be used as a regulator to even out year to year, fluctuations in the yield of the supplementary tax (paragraphs 233-238).

Equity between local taxpayers and implications for Exchequer grant

36. Ministers would need to take a view on how far to seek to preserve a general grant to compensate authorities for differences in resources as well as needs in the final scheme.

37. If Ministers wish to promote equity between ratepayers and shoppers/motorists in different areas, the choice lies between the following:

- (i) limiting the freedom of local authorities to vary the mix of their local taxes. To ensure equity between local taxpayers, local authorities would have to be required to levy property rates and the supplementary tax in a fixed ratio to each other, since otherwise they would be free to load the tax on to whichever group offered the larger potential yield. A fixed ratio could effectively set a limit on the rate of the supplementary tax. It could also be used as a mechanism to promote rate reductions. A fixed ratio would be compatible with a general system of control (see paragraph 39 below). If there were no such system of control, the fixed ratio would cease to operate when an authority had reached its rate limit; and
- (ii) leaving authorities free to determine their own mix of local taxes, but offsetting any attempt to maximise local income through loading

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the tax on to the larger tax base by means of a retrospective adjustment of grant.

38. If neither of these approaches were acceptable, it would not be possible to retain the present concept of resource equalisation between different authorities, although it would still be possible to compensate for differences in needs. Other options, which would need to be further considered, such as resource equalisation in respect of property rates only. This would benefit authorities which were relatively wealthy, at the expense of those which were not (paragraphs 257 to 262).

Central control of expenditure

39. It would be possible to set limits on the rate of supplementary tax. If this were done for all authorities, it would imply a general system of control similar to the interim scheme. As indicated in paragraph 37(i) above a predetermined ratio between the two taxes as a means of securing equitable resource equalisation would in itself imply a general system of control. Alternatively, a scheme to control only exceptionally high spending authorities might be devised, based on options previously examined by MISC 79. Any control system would have the same issues as the interim scheme.

C. OTHER MATTERS

Structural Reform

40. Both the interim scheme, if it ran until 1987/88, and the final scheme, would interact with any decision to alter the structure of the upper tier of local government. The Group foresee no insuperable technical difficulties (paragraph 232):

Reform of the Rating System

41. Ministers will need to consider whether to pursue any of the reforms of the existing rating system which were recommended by MISC 79. (paragraph 281 to 283).

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D. LEGISLATIVE/CONSULTATIVE TIMETABLE

42. An interim scheme could be brought into force in April 1985, if Ministers take a decision in principle by early summer 1983, enter into public consultation on subordinate detail shortly thereafter, introduce a Bill by January 1984, and secure its enactment by Summer 1984. Provisions on minor rating reforms could be dealt with at the same time. If it were thought essential to provide for direct Government intervention in case of default it might prove necessary to make provision for this in a separate Bill introduced in the 1984/85 Session and enacted by March 1985 (paragraphs 95 and 140(xii)).

43. The introduction of a final scheme would need to be preceded by consultation, presumably based on a decision in principle to put a ceiling on rate levels and to introduce a supplementary tax or taxes. The EC complication as regards LST (see paragraph 18 above) suggests that any consultative document should discuss both LST and RFD/VED as alternative options.

44. If LST were to be introduced in 1988 or RFD in 1986, detailed planning on either would need to be started within the next few months. If VED were to be introduced in 1988, prior planning would not need to start until 1986 (paragraph 215).

45. If LST or RFD/VED combined were to come into force in April 1988, a Bill would have to be introduced no later than the beginning of the 1986/87 Session. If RFD were to come into force in April 1986 a Bill would have to be introduced no later than the beginning of the 1984/85 Session (paragraph 199).

46. Separate legislation would be necessary for Scotland, except in respect of the supplementary tax provisions.

T M HEISER
Department of the Environment
18 April 1983

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ANNEX

THE SUPPLEMENTARY TAX OPTIONS COMPARED

| | (ii) | | |
|---|---|---|---|
| | (i) <u>LST</u> | <u>RFD</u> | <u>VED</u> |
| <u>Tax Base</u> | VAT coverage (include business services but not goods for resale) | petrol and derv (business and domestic) | cars, vans motorcycles |
| <u>Taxpayers</u> | 40m adults plus children | 15-20m | 15m |
| <u>'Steps' in rates</u> | 0.1% desirable | 0.1p per litre | £1 minimum cars and vans |
| <u>Fiscal Implications</u> | Affects VAT | Affects national RFD | <u>Transfer</u> of tax, made up from other revenues |
| <u>RPI effect</u> | very small increase | very small increase | very small increase |
| <u>Timetable (earliest)</u> | 1988 | 1986 | 1988 |
| <u>Manpower</u> | CG: 2000-3000 LG: 'few hundred' | CG: small LG: 500-1000 minimum | CG: say 700 (200 new) LG: 1000 (all new) |
| <u>Compliance</u> | costs high for upto 1m outlets | costs high for 50,000 outlets | additional costs negligible |
| <u>Enforcement</u> | by <u>Customs</u> | by <u>LG</u> | mainly by <u>LG</u> |
| <u>Collection</u> | by <u>Customs</u> | by <u>LG</u> | by <u>DTp</u> |
| <u>Cross-border Shopping</u> | major issue for all retail businesses (especially if on district area base) | major issue for petrol/derv retailers | minor problems: registration of fleet-hire cars in low tax areas |
| <u>Perceptibility</u> | Poor | Poor | Good for taxpayers |
| <u>EC Implications</u> | Possibly significant; | None | None |
| <u>Predictability of local Yield</u> | difficult to predict | very difficult to predict | relatively easy to predict |
| <u>National yields (1983/84 prices)</u> | 0.1% = £175m | 0.1p per litre = £34m | £1 = £17½m |

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REPORT OF THE INTERDEPARTMENTAL GROUP ON LOCAL TAXATION

I INTRODUCTION

1. The Secretary of State for the Environment was invited to arrange for officials to report on:

- i. an interim scheme designed to achieve a freeze on domestic rates or a strict limitation on rate increases, with any necessary increase in the Exchequer contribution by Rate Support Grant (RSG) or otherwise; followed by -
- ii. a final scheme based on a permanent ceiling on rates, coupled with a new supplementary tax or taxes on expenditure, and perhaps a continued control over either expenditure or the maximum level of local taxation.

(E(LF)(83) 1st, of 16 February, as modified by E(LF)(83) 2nd, of 14 March).

The Group have interpreted the first part of their remit as applying to both domestic and non-domestic rates, and not only to domestic rates as recorded in E(LF)(83)2nd, because if domestic rates alone were controlled local authorities would be able to make good any loss of income through unlimited increases in non-domestic rates.

2. This report relates to Great Britain. Except where otherwise stated, England and Wales are dealt with together, and Scotland separately. The special circumstances in Northern Ireland have not been examined at this stage.

3. The membership of the Group is set out in Annex A.

LOCAL GOVERNMENT EXPENDITURE AND FINANCE

4. The broad features of the present structure, functions and financing of local government in England and Wales are set out in Annex B.

(i) Performance since 1979

5. Since the Government took office it has sought to contain and reduce local government expenditure by a policy of increasing local government accountability:

- (a) Aggregate Exchequer Grant (AEG) has been reduced from 61% of planned relevant expenditure for rate support grant purposes in England and Wales in 1979/80 to 52.8% in England and 70.4% in Wales, which gives an England and Wales figure of 53.8% in 1983/84 - equal to 58% of actual expenditure in 1979/80 and 52% of budgetted expenditure in 1983/84;
- (b) the block grant system together with Grant Related Expenditures (GRES) is intended to discourage high spending. Additional pressure is applied through expenditure targets and grant holdback.
- (c) mandatory provisions have been introduced for publication of information on manpower etc;
- (d) a mandatory accounting and competitive regime has been established for direct labour organisations;
- (e) encouragement has been given to the contracting out of services to the private sector;
- (f) an Audit Commission for local government in England and Wales has been established, with a remit to expand value for money audit, and to increase the proportion of local government audit undertaken by the private sector.

6. Annex C (i) shows how expenditure and manpower have changed in England and Wales since 1979 (with a longer term comparison with the mid-1970s). It also shows the rate increases and the rate of inflation experienced by local government over the period.

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7. The long term growth in current expenditure in volume terms has been halted and is now slightly less than the peak in 1979/80. In cost terms (using GDP deflator) local authority expenditure has continued to rise. Manpower (full time equivalents), the major constituent of local authority costs, has fallen by nearly 5% since its peak in June 1979. Numbers employed (full time plus part time) are now lower than at any time since 1975. On the other hand, local authorities have continued to spend more than the Government has allowed for in its public expenditure plans - in 1983/84 they are planning to overspend by £750m (3.8%) in England and £20m (1.7%) in Wales. But the vast majority of authorities have responded to the Government's expenditure targets, and most of the overspending is the responsibility of a few authorities. For example, in 1982/83, half the budgetted £1400 m overspend in England was accounted for by 16 authorities. In 1983/84, half is accounted for by two authorities - GLC and ILEA.

8. Until this year, rate increases have been running well ahead of the general level of inflation. In England rate poundages increased by about 77% between April 1979 and April 1983, whilst the RPI increased by about 55%. Over the same period rates in Wales increased by 44%. Rate increases would have been lower had local authorities spent in line with Government plans. Because they did not, the reductions in grant percentage, which were intended to go hand in hand with expenditure cuts, actually added (perhaps a third) to the rise in rates.

(ii) Income and Expenditure

9. In 1982/83 local authorities' estimated gross revenue expenditure in England and Wales was £33 bn. (The broad distribution in percentage terms between the main services for each class of authority in England and Wales for 1981/82 is set out in Appendix I to Annex B.) This is expected to be financed by:

| | | England | Wales |
|-------------------------|---|---------|-------|
| Government grants | - | 44% | 55% |
| Domestic rates | - | 13% | 9% |
| Non-domestic rates | - | 18% | 13% |
| Rents, fees and charges | - | 18% | 17% |
| Other income | - | 7% | 6% |

The detailed income and expenditure account for 1981/82 (the latest year for which full details are available) is set out for England at Annex D(i) and for Wales at Annex D(ii). Rate levels (or the precept issued by the upper tier) are

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ed in the light of what an authority judges to be acceptable locally to finance its chosen level of expenditure, after taking into account likely income from government grants, rents, fees and charges and internal sources of income (eg transfers from special funds). Within limits an authority may choose to use balances to influence its rate or precept increase, perhaps to stabilise year by year changes. Alternatively, an authority may decide to build up its balances as a cushion for use in future years (including local election years).

(iii) Aggregate Exchequer Grants

10. Local government revenue expenditure in England and Wales is supported by:

- (a) relevant specific and supplementary grants for services thought to justify additional support, such as the police (at settlement these totalled £2,200 million in 1982/83);
- (b) domestic rate relief, which reduces the local general rate by $18\frac{1}{2}$ p in the pound over £700m: £703m in 1982/83;
- (c) block grant (estimated at £9080m after holdback in 1982/83).
- (d) certain specific grants defined as non-relevant for RSG purposes, mainly grants in support of mandatory student awards and housing benefit. (Housing expenditure also attracts a general housing subsidy.)

The first three of these (a, b and c) taken together are known as the Aggregate Exchequer Grant (AEG). Domestic Rate Relief and block grant are together known as Rate Support Grants (RSG).

11. Block grant is calculated with reference to the Government's expenditure plans for the local government services for the year, but is paid as an unhypothecated sum. Local authorities remain free to choose their own relative priorities between services.

12. Block grant does two things. First, it provides flat rate financial assistance to local authorities to keep the rates down. Secondly, it incorporates mechanisms to ensure that any two local authorities providing a similar level of service to their ratepayers will be in a position to levy the same rate

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poundages. Without these mechanisms, first, authorities with low expenditure needs (eg relatively fewer schoolchildren) would be able to provide a standard level of service for lower rate poundages than those with high expenditure needs (eg relatively more old people). And secondly, authorities with high rateable resources (eg on account of more offices) would be able to provide a standard level of service for lower rate poundages than those with low rateable resources (eg on account of low quality housing). This compensation for differences between authorities' expenditure needs and resources is known as "equalisation". Of the £8,600m block grant in England before holdback in 1982/83, £2,600m (30%) will be used to equalise needs. £1,600m (19%) will be used to equalise resources. The remaining £4,400m (52%) effectively will be paid as a subsidy to produce a standard reduction in rates across the country.

13. Without this compensation for the differences in the needs and rateable resources of authorities, rate burdens across the country would change dramatically. Assuming the whole of block grant were paid as a standard amount per head, and that authorities made no use of balances, then 1982/83 rates in Tandridge (Surrey) would have fallen by 65p (-48%) and in Westminster by 29p (-20%). On the other hand, rates in Liverpool would have increased by 56p (+28%) and in Wandsworth by 36p (+24%).

14. The equalisation of local authority rateable resources has come under strain because of the use of rateable values as a measure of local wealth. Local authorities whose high resources are due primarily to high domestic rateable values argue that rateable values are not a good measure of the relative capacity of their ratepayers to pay higher rate bills. Local authorities with high non-domestic rateable values point to the absence of a general rating revaluation in England and Wales since 1973 and argue that the relativities in the values of shops, factories and offices between different areas are out of date.

15. For each authority block grant is paid at a constant proportion of each pound of expenditure, depending on the relationship between its total rateable resources, its population and its needs assessment (GRES). Where an authority is spending at or above a specified threshold in relation to its GRE, its marginal rate of grant is reduced. This is known as the "taper". There are technical differences between the mechanisms in England and Wales, but the principles are the same. Where an authority chooses to spend at levels above its needs assessment, subject to a reasonable tolerance, it has to find a larger proportion

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of the cost from the rates or other sources. Since 1980/81 in England and 1982/83 in Wales authorities have also been subject to individual expenditure targets, principally derived from the Government's expenditure plans. Where authorities do not plan to spend in line with their targets they have been subject to holdback of block grant.

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III CONTROL OF LOCAL AUTHORITY RATES IN THE INTERIM SCHEME

16. The object of the interim scheme would be either (a) to freeze rate levels or (b) to permit rate increases subject to a limit or set of limits. The term "rate" in this section includes precepts by the county councils, the 3 park authorities, and ILEA. Special considerations apply to the Metropolitan Police, whose precept is fixed by the Home Secretary.
17. For the reasons discussed in paragraph 42 and 43 below it would not be practicable to make the 11,000 parish, town, and community councils and the 260 internal drainage boards directly subject to control; but their expenditure might be indirectly influenced through the rate limits set for the bodies on which they precept.
18. A control scheme for local authorities would need to be based on general rules. But there would inevitably be cases requiring exceptional treatment; and the tighter the rules were drawn the more such cases there would be. The scheme would therefore have to provide for a system of derogations, to be granted by the Secretary of State.
19. The issues raised by the interim scheme are considered below in relation to:
- A: Limits on rates or rate increases
 - B: "Safety valves"
 - C: Applications for derogations
 - D: Public expenditure and Exchequer grant
 - E: Transition
 - F: Intervention
 - G: Other Issues
 - H: Manpower implications
 - I: Annual timetable
 - J: Scotland
 - K: Issues for Ministers

A LIMITS ON RATES OR RATE INCREASES

20. Local authorities have three main sources of income: (a) rates, (b) grant, and (c) fees and charges (including rents). Income from fees and charges is

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netted off gross expenditure; and cannot in any case readily be made subject to direct control (see paragraph 53 below). Thus any control system has to take account of the fundamental equation:

$$\text{net expenditure} = \text{rates} + \text{grant}$$

If any two of these are controlled directly, the third will also be controlled consequentially. There are thus three basic models for a control scheme: A, in which expenditure and rates are directly controlled; B, in which rates and grant are directly controlled; and C in which expenditure and grant are directly controlled.

21. A control scheme could also build on the existing arrangements for influencing expenditure: in particular on GREs (which are formula based measures of the cost of providing a standard level of service), and on the expenditure targets (which are formula based measures of what the Government regards as a "reasonable level" of expenditure for each authority, to exceed which incurs loss of grant). In practice each of the basic models could be developed in a variety of ways, making different use of this established machinery. Each of the schemes described below starts from one of the basic models, and incorporates particular features which seem to be useful and practicable; but other variants are possible.

(i) Description of Schemes

Scheme A(i) - A freeze on rate levels:

22. Scheme A(i) would involve:

- freezing rate poundages;
- setting "reasonable budgets" for net expenditure (equivalent to "expenditure targets" under the present RSG system);
- paying a deficit exchequer grant to each local authority equivalent to the difference between the income from the frozen rate (allowing for increases or decreases in rateable value), and "reasonable budget" expenditure.

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Block grant would be suspended in favour of the new exchequer deficit grant.

Scheme A(ii): Limitation on rate increases

23. Scheme A(ii) would be the same as Scheme A(i) except that maximum permitted rate increases would be specified, either nationally or for each class of authority.

Scheme B(i) - A freeze on rate levels

24. Scheme B(i) would involve:

- freezing rate poundages;
- allowing the present block grant system to operate independently;
- leaving each authority's permitted expenditure to be derived from its rate income and its grant entitlement.

There would be no "reasonable budgets" approved by Government but there would be expenditure assumptions for individual authorities underlying the grant distribution.

Scheme B(ii): Limitation on rate increases

25. Scheme B(ii) would be the same as scheme B(i) except that maximum permitted rate increases would be specified nationally, or for each class of authority, as in scheme A(ii).

Scheme C: Limitation on rate increases

26. Scheme C would involve:

- setting "reasonable budgets" for net expenditure;
- maintaining the block grant system;
- leaving each authority's permitted rate limit to be derived from its block grant entitlement for spending at the "reasonable budget" level.

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27. Where derogations were granted under schemes which froze rate poundages (A(i) and B(i)), extra grant would be payable. Under schemes which controlled rate increases, (A(ii) B(ii) and C), the granting of a derogation would entail a higher rate increase than permitted under the general rules.

(ii) The Base Line for Controlling Rates

28. In both versions of Schemes A and B, decisions would be needed on a base line for calculating the frozen rate poundages or rate increase limits. The choice is between the rate levels of 1983/84 or of 1984/85. There would be advantages in using those of 1983/84. Rates for that year have now been set, and it would thus be possible to avoid validating any increase in rates made in 1984/85 by authorities seeking to anticipate the introduction of a control scheme in 1985/86. If rates were to be frozen, they could be set either at the general level of 1983/84 (thus implying a requirement to reduce rates where they had been increased between 1983/84 and 1985/86), or at the 1983/84 level updated by a factor to allow for inflation. If there were to be maximum rate increases, those allowed in 1985/86 would need to take account of local authority cost increases for both 1983/84 and 1984/85.

29. It might be necessary to make a general adjustment to the 1983/84 rate levels to discount that element of rates which was attributable to grant "holdback" in that year. Otherwise authorities which had increased their rates as a result of high spending in 1983/84 would be given an unjustifiably high rate base. The nature and scale of the adjustment would depend partly on whether there had also been a system of targets and holdback in 1984/85. Ministers have not yet taken a decision on this.

30. Under scheme C, there would be no need for a base line for the rate increase limits. As explained above, the rate limits for individual authorities would be derived from their "reasonable budgets" and their block grant entitlements. The base year for calculating "reasonable budgets" would be 1983/84. This would discount any advantage from expenditure increases in 1984/85 which might otherwise occur.

(iii) Rate reductions

31. If rates were to be frozen, as under schemes A(i) and B(i), some authorities could well be able to levy rates below this level. There seems a good case for

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allowing year on year fluctuation in rates; provided they remained below the ceiling. This would give the more responsible authorities more flexibility in operating their finances. The Group have assumed that rate reductions would also be allowed under schemes which limited rate increases.

(iv) Assessment of schemes

Rates freeze/increase limitation

32. Under scheme A, the frozen rate or permitted rate increase would be set directly on the basis of general rules for all authorities or classes of authority, by reference back to actual rate poundages in a base year. There would thus be no allowance for the extent to which the rate levied in the base year was influenced by contributions from balances. Authorities which levied low rates in the base year by drawing on balances (as often happens in years of local elections) would tend to continue to have lower rates throughout the interim period; conversely for authorities which rated to add to balances in the base year.

33. Under scheme B the rate limit would be set in the same way as in scheme A; and would similarly take no account of any use of balances in the base year. But whereas under scheme A grant would be specifically adjusted to ensure that each authority's income was sufficient to meet its "reasonable budget", under scheme B there would be no explicit setting of "reasonable budgets". (It would however be technically necessary to make an assumption about the expenditure levels of individual authorities in making the RSG settlement). As a result, the rate limits would allow differential year on year expenditure changes between authorities, regardless of their original levels of expenditure and changes in their needs. An authority losing block grant, or which kept rates down by using balances in the base year, might have to reduce its expenditure, whereas an authority gaining grant, and/or which increased its rates to allow for additions to balances in the base year, would be allowed larger expenditure increases.

34. In contrast, under scheme C rate limits would be determined as a consequence of reasonable budgets and the operation of the grant system. In effect, they would be equivalent to the rate required to bridge the gap between an authority's "reasonable budget" and its grant entitlement. In this way, scheme C would be fairer to authorities; any differences in permitted year on year expenditure

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increases would be the result of explicit decisions on how to set the "reasonable budgets" (ie whether they should be "skewed", see paragraph 36 below). But because the rate limits in scheme C would be determined as an output from the system, they would imply different year on year movements in actual rate levels between authorities. In other words, the more that "reasonable budgets" are "skewed" and the greater the changes in grant distribution (eg due to GRE changes), the more uneven the resulting pattern of rate changes under scheme C.

35. In all the schemes, the frozen rate or permitted increase would be set in terms of the rate poundage rather than in terms of the bill paid by the ratepayer. If rate poundages were frozen across the board, the bills paid by ratepayers would also be frozen, unless the rateable value of their property changes.

"Skewing"

36. Under both schemes A and C there would be a strong case for authorities' "reasonable budgets" to be "skewed" both to allow different year on year expenditure changes for low spending authorities and high spending authorities relative to their expenditure needs and to take account of changing needs; GRE assessments could be used for this latter purpose. Under scheme A, differences in year on year expenditure increases would be wholly reflected in year on year changes in grant, since rates would be either subject to the initial rate freeze or allowed to increase to the same extent for all authorities. Under scheme C, differences in year on year expenditure increases would be reflected in different implied changes in rate poundages. Under scheme B the option of "skewing" would not arise in the same way since there are no explicit "reasonable budgets". Under schemes A and B it would be possible to skew the permitted rate increases (as distinct from the "reasonable budgets") should that be judged desirable.

Definition of permitted rate increases

37. Under Schemes A(ii) and B(ii), which would limit permitted rate increases, the maximum increase could be set either as a uniform poundage increase for each class of authority (eg 5p for shire counties, 1p for shire districts, etc), or as a percentage increase on each authority's poundage in the base year. Uniform flat rate poundage increases would give more headroom to low rating authorities; they would also allow greater percentage increases in rate bills in such areas.

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Uniform percentage increases in base poundages would give more headroom and more cash to those with higher rates. This is illustrated in the following tables related to the shire districts and counties in England.

Table A. 5p increases on 1982/83 poundage

| | Shire Districts | Shire Counties |
|---------|--------------------------|------------------------------|
| Lowest | 6p + 5p = 11p (up 83.3%) | 117½p + 5p = 122½p (up 4.3%) |
| Highest | 51p + 5p = 56p (up 9.8%) | 156p + 5p = 161p (up 3.2%) |

Table B. 5% increases on 1982/83 poundage

| | Shire Districts | Shire Counties |
|---------|----------------------------|-------------------------------|
| Lowest | 6p + 5% = 6.3p (up 0.3p) | 117½p + 5% = 123.4p (up 5.9p) |
| Highest | 51p + 5% = 53.5p (up 2.5p) | 156p + 5% = 163.8p (up 7.8p) |

38. Insofar as the increase limits were intended to reflect changes in costs, there would be an argument for setting them in percentage terms. On the other hand, this could have the effect of widening disparities in levels of service and would put no pressure on extravagant authorities to reduce their spending.

39. For Scheme C the choice between uniform flat rate poundage increases and percentage increases does not arise. As explained above, the permitted rate for each authority, which might be an increase or a decrease on the previous year's poundage is a residual, filling the gap between each authority's block grant entitlement and its "reasonable budget" level of expenditure.

Implications for transition from interim scheme into final scheme

40. Schemes B and C, unlike scheme A, would preserve the block grant system and equalisation of needs and resources. This would make the transition to the final scheme much easier if it were desired to preserve these features of the grant system in the final scheme (see paragraphs 239-262 in Section IV).

Derogations

41. Local authorities are likely to seek derogations from the limits and/or challenge them in the courts on the grounds - among others - that they do not take account of the varying circumstances of individual authorities. There are

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two aspects to be considered here. The first concerns the operation of the grant system. Scheme A would be more vulnerable to risk of legal challenge than schemes B or C, unless authorities' "reasonable budgets" were 'skewed' to take account of changing circumstances (see paragraph 36). The second aspect, concerns how the rate limits are set. In this respect, Scheme B would be more vulnerable than schemes A and C, since the rate limits would not be based on "reasonable budgets" and would permit differential year on year expenditure increases (and in some cases reductions) for authorities. Authorities losing grant, or whose rates in the base year were artificially depressed by the use of balances, might be required to make expenditure reductions that could not be defended as "reasonable". Scheme C has the advantage over the two other schemes that the rate limits would be an outcome of both "reasonable budgets" (which could be skewed) and the operation of the grant system. The overall number of derogations might therefore be lower.

Lower tier authority precepts

42. Precepts by the lower tier authorities (ie mainly by parish, town or community councils and by internal drainage boards) levied on rating authorities vary from authority to authority. In 1982/83, lower tier precepts were equal to 0.3% of all rate income in England and Wales, but in some instances were equal to as much as 50% of the district level rate. It is clearly impracticable to set up a control scheme applicable to over 11,000 such lower tier authorities. It would also however be undesirable to exclude the lower tier precept from the control of the relevant local authority rate in which it is now reflected, especially as a rating authority might be able to evade the control by securing the agreement of a lower tier authority to carry out expenditure it might itself otherwise carry out under concurrent powers. The most significant concurrent activities are the provision of recreation facilities (swimming pools, community halls, parks and allotments) and parking places, footway lighting and bus shelters.

43. A simple solution would be to allow the rating authority to take the strain of any increase in the lower tier precept within its frozen rate or permitted rate increase, and for the Secretary of State to take this factor into account when an application for a derogation is made (see paragraph 70(g) below). This solution could well produce inequities. The Group consider, therefore, that additionally a uniform limit might be set on the precepting powers of all parishes. Such a limit, set in terms of a rate poundage, would have to be set high to avoid the need for derogations, given the wide disparity between the

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parishes in terms of the present levels of activity and rate, and would therefore be too broad an instrument to have much effect on the aggregate level of precepts. But it might help to restrain any tendency for individual parishes to rate excessively and thereby jeopardise district rate limits. Another alternative might be to place a low, absolute poundage ceiling on parish powers to precept (as was the case before 1972) but to give a power for the District Council to transfer some of its limited rate poundage to its parishes.

(v) "Reasonable Budgets" and rate increase limits"

44. Rates and Exchequer grant together accounted for 75% of local authority gross revenue income in England in 1982/83. Another 18% was attributable to fees, charges and rents, the remainder being accounted for by interest receipts and other income. The comparable figures for Wales are 77% and 17%. By controlling both rates and Exchequer grant the Government would therefore exercise an important influence on local authorities' gross expenditure; and would constrain their net expenditure, which is defined as being net of income from fees, charges and rents. The use of balances to finance expenditure is discussed at paragraphs 54-56.

45. The "reasonable budgets" under Schemes A and C or "expenditure assumptions" under Scheme B would need to be consistent with the Government's public expenditure plans for local government services. They would need for instance to incorporate the Government's assumptions about pay and price movements. It would be necessary to ensure that the net public expenditure provision was set at a level within which local government could reasonably be expected to remain, otherwise there might be a very large number of applications for derogations and the Government could find itself obliged to grant a substantial proportion of them in order to minimise the risk of successful legal challenge (see paragraphs 70-79 below). In the transition to the first year of the control scheme it could therefore probably be necessary to "write off" any overspend in 1984/85 and increase the public expenditure provision for 1985/86 accordingly.

46. For schemes A and B the frozen rate poundages or rate increase limits would be derived from the total public expenditure provision and the total provision for Exchequer grant. They too would need to be set realistically in order to keep the number of applications for derogations within manageable limits. In 1982/83 rate changes in England varied from -40p to +46p, ie from -44% to over +90%. (See

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Annex E(i)). There was an even wider range in 1981/82. For 172 authorities (41%) in 1982/83 the rate increase was greater than the average increase in local authority costs; for 188 it exceeded the Government's pay and price provision of 6%. Rate changes in 1983/84 seem to be less widely spread and 147 authorities have increased their rates by more than the current rate of inflation (5%).

47. The range of rate changes in Wales for each period is significantly narrower than for England. In both 1981/82 and 1982/83 the changes varied from about +10p to +35p (about +9% to +34%). Only 11 out of the 45 authorities in Wales had a rate increase in 1982/83 in excess of either the average rise in local authority costs, or the Government's 6% provision for pay and prices. In 1983/84 the range of rate poundage changes is -16p to +16p (-11% to +12%). Indeed only 7 authorities have increased their rates for the forthcoming year by more than the going rate of inflation (5%).

48. The number of authorities with rate increases in 1982/83 above the average increase in costs of the Government's pay and price provision would have been lower if the expenditure and grant provision had allowed for actual cost increases effecting local authorities and if the overall grant percentage had not been reduced. Much of the variation in rate increases remaining after discounting the factors noted in paragraph 5 of Annex E(i) is attributable to the individual decisions of authorities on the use of their balances in setting their rate levels in a particular year.

49. The interaction of public expenditure provisions and the rate increase limits is further discussed in paragraphs 80-90 below.

B "SAFETY VALVES"

50. Apart from rates and RSG, authorities would still be able to look to a number of other sources to finance their spending levels.

Specific and Supplementary grants

51. There is some scope for using specific or supplementary grants in support of revenue expenditure. Some specific grants, eg for police expenditure, are 'open-ended'. In practice they would be limited to the extent that control of

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rates influenced expenditure on the services subject to such grants. It might be necessary to consider further Government action, for example by cash-limiting or relating grant to specific projects.

52. Of the supplementary grants, the most important in England is the Transport Supplementary Grant (TSG), which is in the control of Central Government. In Wales, TSG is paid only in support of capital expenditure.

Fees, charges, and rents

53. Local authorities would remain free to determine their fees, charges, and rents, which in 1982/83 accounted for 18% of gross revenue income in England and 17% in Wales. But in considering applications for derogations Ministers would need to take a view on the extent to which each authority could be expected to finance its proposed expenditure from these sources.

(a) The scope for rent increases varies between different authorities, and all such increases are ultimately governed by the requirement that rents be reasonable, and that authorities are seen to be exercising their local discretion in setting rent levels. The scope for increasing rental income is likely to be least in the case of those authorities whose rents are already relatively high, a number of which happen to be those that would be placed under the greatest pressure to reduce rate-borne expenditure.

(b) There would be scope for some significant increase in public transport fares in the metropolitan counties; but a decision to refuse a derogation on the grounds that fares should be increased instead could attract criticism, particularly in London.

(c) Local education authorities might be required to increase charges for school meals; the effect on gross expenditure would depend on the effect on demand.

Balances

54. Over the years local authorities in England have accumulated a surplus of revenue account income over expenditure (ie revenue balances) of about £1500m by the end of March 1983. These funds have been 'loaned' temporarily to the

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authorities' capital accounts to finance capital expenditure. Since authorities have the power to refinance these loans with external borrowing (from money markets) the revenue balances are potentially available to finance additional revenue expenditure without recourse to additional income (from rates, grants etc). In a similar way authorities have accumulated surpluses on special funds (£1000m) and capital accounts (£2300m) that are temporarily invested internally. But only some £500m of special funds and capital account balances could be made available to finance additional revenue expenditure. The maximum expenditure potentially at risk in England from revenue and other balances is therefore around £2000m - equivalent to about 10% of net current expenditure in 1983/84 - although authorities could increase this by rating up in 1984/85. In Wales authorities are estimated to have carried forward into 1983/84 balances of the order of £130m. When the accumulated surpluses on special funds, and capital accounts that could be available to finance additional revenue spending (about £20m) are taken into account the aggregate of revenue and other balances amounts to £150m (or 12% of estimated net current spending in 1983/84).

55. In practice authorities need balances as a reserve against unforeseen shortfalls in income or increases in expenditure. On past performance, authorities might be expected not to reduce balances. But the Group cannot predict how they might respond to a control system, and believe they might use some but probably no more than around £500m of the balances in England and Wales (ie 2½% of net current expenditure) presently available to circumvent the new controls, and probably less. Moreover this money can be used once only, so it would quickly be sweated out of the system. To the extent that authorities do use balances there would be a corresponding increase in the Local Authority Borrowing Requirement (LABR) as internal loans were replaced with market borrowings. What will actually happen to balances will however depend on the aggregate of local political decisions rather than purely professional judgements by Chief Financial Officers.

56. It would be very difficult to control the creation or use of balances by legislation. There is a fundamental operational problem insofar as it is only possible to calculate actual balances after the close of a financial year, and to provide very broad estimates of the closing balance before the end of that year. Moreover it would involve breaking new ground in defining in statute in great detail the content and operation of all local authority accounts. It is very unlikely that such legislation could be developed in watertight form for introduction by January 1984.

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Mutual aid

57. There is some scope for 'mutual aid' between sympathetic authorities (ie with concurrent powers in different tiers in the same areas) to maximise their collective headroom, but this seems very limited.

Conclusion

58. In general apart possibly from some further restraint on the use of specific grants (paragraph 51) the Group consider that it would be very difficult to take effective action to block off the sources of finance set out in paragraphs 50-57 above. Moreover there might be some positive virtue in regarding these as 'safety valves', which would tend to reduce the number of applications for derogation and provide good grounds for rejecting many such applications.

C APPLICATIONS FOR DEROGATIONS

59. Local authorities unable to meet their spending plans within their frozen rates or rate increase limits would have to apply for derogation to the Secretary of State for the Environment (or Wales).

(i) Parliamentary procedure:

60. The first question to consider is the form of Parliamentary authority for derogation. There are two possibilities:

(a) Parliamentary approval of the Secretary of State's recommendations in individual cases, as under the current arrangements in Scotland, where the Secretary of State may specify rate or grant reductions for individual local authorities.

(b) A power for the Secretary of State to decide whether or not to grant applications for derogations, subject only to judicial review.

61. Parliamentary approval of individual cases might help to reduce the involvement of the courts and the risk of adverse decisions. But there is no reason of principle why the courts should accord a greater degree of authority to a statutory instrument approved by Parliament than to any other executive act;

and in a clear case of absence of power or procedural impropriety it is inconceivable that they would disregard irregularity of substance merely on account of its being formally subject to Parliamentary approval. Moreover anything more than a handful of individual cases would be impracticable in terms of the demands on the Parliamentary timetable. The Group therefore consider that the scheme must be developed on the basis of (b) above. It could be argued in support of this approach that the Scottish system is based on rate reductions and/or withdrawal of grant, whereas the proposed control system would be based on conceding either more grant, borrowing approval or more rate income if a derogation is approved.

(11) Ministerial responsibilities

62. Local authorities are responsible for certain services of national consequence, such as education, personal social services, police, fire, transport and highways. The imposition of a rate control scheme could have implications for Government policies in relation to those services, since in varying degrees successful implementation of those policies depends critically on the co-operation of the local authorities concerned. The tighter the control of rate increases, and therefore of net revenue expenditure (which has implications for the capital as well as the current account) the greater the risk of refusal of co-operation by individual authorities, or of difficulty in meeting the requirements of service Ministers. These risks could arise in the case of responsible low spending as well as high spending authorities.

63. Service Ministers at present give a variety of advice and guidance with expenditure implications to local authorities, who would be ready to exploit any apparent divergence in the approach adopted by individual Government Departments. For example, given Government priorities, a high spending authority might well base an application for derogation on the effect the rate limit would have on law and order or civil defence spending. If a control scheme were introduced, it would be necessary to undertake a review of the requirements placed on local authorities by service departments, to ensure consistency with the requirements of the control scheme.

64. It would be an essential feature of any rate control scheme that the Secretary of State for the Environment, after consulting other Ministers concerned with individual services where relevant, must (as the Attorney General

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advised MISC79 on 7 January) decide himself whether to grant a derogation and if so how much additional grant or rate increase, or temporary borrowing, to allow. Decisions would need to have regard to the statutory duties placed on service Ministers (see Annex F(i)). For example, the Secretary of State's decision whether to allow a derogation might need to override, at least by implication, advice given by HM Inspector of Constabulary or of the Fire Service about the standards of the police or fire service in an individual local authority which the Home Secretary is at present statutorily obliged to take into account. The Home Secretary also authorises police force establishments and is required to give or withhold approval, having regard to public safety, to reductions in numbers of firemen. He also approves the Metropolitan police and certain other budgets. Under the Transport Act 1983 the Secretary of State for Transport sets protected expenditure limits for public transport revenue support. These limits are themselves be open to legal challenge. The Secretary of State for Education and Science is required to consider complaints made under the 1944 Act asking whether he is satisfied that an LEA has failed to discharge any of its duties under the Education Acts or has acted unreasonably in exercising any duties or powers. Consequently, even though legislation would need to confer on the Secretary of State for the Environment authority for deciding whether a given level of expenditure should be permitted, and the final decision would be his alone, it is essential that there should be close consultation between the Department of the Environment and the other service departments concerned in the case of individual applications.

65. The same issue arises in Wales but is restricted to Home Office Services, the Secretary of State for Wales having final overall responsibility for all non Home Office local authority services. It does not arise in Scotland where the wide service responsibilities of the Secretary of State have facilitated the existing comparatively limited scheme of direct control over local authorities' spending (see Annex F(ii)). Indeed, the level of service provision has played only a minor part in the consideration of excessive and unreasonable expenditure in Scotland.

(iii) Extra grant, additional rate increases or temporary borrowing

66. Where an application for derogation is successful, additional expenditure will be approved. If rates were frozen (as in Schemes A(i) and B(i)) this expenditure would have to be financed by extra Exchequer grant.

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67. In the case of the permitted rate increase schemes (A(ii), B(ii), and C), the additional finance required might be met either by temporary borrowing or by allowing a higher rate increase. If the additional finance were to be met by a higher rate increase this would mean resurrecting in England and Wales and introducing in Scotland a power to levy what would be in effect a supplementary rate. This need would arise because of the time required to examine applications for derogations and ensure consistency of decisions. If permitted rate increases were announced in December, it would almost certainly be impossible for Ministers to decide on all the applications for derogations before precepts are set in February and rates in March. It would therefore be necessary to allow authorities to levy a provisional rate to take effect in April and a final rate to be fixed some time into the financial year.

68. There is a case for conceding temporary borrowing to meet non-recurring expenditure, for example on emergency works, or where the sum involved is relatively small and would not justify the substantial administrative cost of levying a supplementary rate, and to concede a higher rate increase in other circumstances. On the other hand, it could be argued that if temporary borrowing only is available in response to an application for derogation, this might put greater pressure on authorities to make economies and avoid applications for derogation. Whichever choice Ministers make, they might want to consider whether it is necessary or desirable for the same rule to apply in England and Wales and in Scotland.

69. In either case, the derogation might be made subject to conditions (eg to end contractual commitments or achieve redundancies.)

(iv) Legal Challenge

70. Local authorities would be likely to advance a very wide range of arguments in support of applications for derogations:

(a) legal obligations to provide services and to have regard to public health and safety etc;

(b) Government advice and guidance based on Government policies and the specific duties of service Ministers (eg see paragraphs 63 and 64);

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- (c) pay settlements, especially those to which the Government is party such as teachers and police, where the settlement was above the level assumed when rate limits were set;
- (d) evidence of local needs which influence expenditure (eg size of client groups, social and physical characteristics, GRE assessments);
- (e) comparisons with other authorities (either neighbours or in some cluster analysis of 'comparables'). As derogations proceed these will be joined by arguments of precedent;
- (f) contractual commitments, including redundancy payments and other employment items (some statutory);
- (g) lower-level precepts over which rating authorities have no control (see paragraphs 17, 42 and 43);
- (h) contingencies and emergencies (weather etc);
- (i) various local factors which have in the past either created an "unfairly" low present rates baseline, or led to an "unavoidably" high present rates baseline;
- (j) an electoral mandate.

71. Departments would need to develop a series of criteria for the consistent consideration of such applications - a form of 'case law' - in order to minimise the grounds for challenge. The basic judgement would have to be made by reference to the aggregate financial position of a local authority rather than the circumstances of an individual service. Departments would therefore, for example, have regard to the GREs and previous spending behaviour of the authority concerned. Even where the authority's case for a derogation was based on the implication for a single service, it might be necessary to look at its budget service by service, to ensure that the derogation was justified by the authority's financial position overall. Such consideration would involve consultation with service Ministers before any application was refused.

72. Some authorities may challenge in the courts the decisions of the Secretary of State on applications to him for derogations. Legal arguments will probably focus on whether such decisions are unreasonable because the Secretary of State has:

- (a) failed to take into account relevant considerations;
- (b) taken irrelevant matters into account;
- (c) had a closed mind or fettered his discretion;
- (d) exercised his powers incorrectly or exceeded them;

(v) Implications of risk of legal challenge

73. A major issue arises over paragraph 70(a). The imposition of rate ceilings or limits on permitted rate increases is complicated by the existence of statutory duties placed on local authorities in relation to the various services they provide, including police, fire, education and PSS (See Annex F(i)). In general such duties are not expressed in terms of minimum standards. Nevertheless, they would certainly be adduced by local authorities in support of applications for derogations and in subsequent legal challenges. It does not seem practicable, even if it were acceptable on policy grounds, to revise all such legislation so as to eliminate the risk of conflict between statutory duties and the limits to be imposed under the interim scheme. In Scotland it has been possible to reduce the risk of conflict by demonstrating that a particularly high-spending authority subject to control has been spending more freely on particular services than a selected group of "comparator" authorities. This would be less easy in a scheme of general rates control, such as the Group is asked to consider, which is to apply to all authorities and would therefore be likely to affect relatively low as well as high spenders.

74. An equally important issue arises on paragraph 70(b). As suggested in paragraphs 62-65 above, it would be necessary to review the advice and guidance given to local authorities by service Ministers where there are expenditure implications, to seek consistency with the control scheme, and to secure interdepartmental consultation on applications for derogations, to seek consistency in decisions.

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75. The Group have considered whether it would provide a further safeguard against legal challenge if the Secretary of State were empowered to seek reports on applications for derogations from the Audit Commission or a management consultant from an approved list. The Group advise against this because:

- (a) it could hinder the Audit Commission from developing good working relationships with local authorities, which are essential if it is to secure greater value for money in local government services;
- (b) management consultants may not have enough detailed knowledge of local authorities to produce in the initial years of a control scheme reliable and relevant reports; and applications for derogations may raise policy issues for Ministers on which management consultants could give only limited help;
- (c) the problems of reaching defensible decisions in good time would be increased if this further step in the procedure were introduced.

76. The risk of successful legal challenge would depend to a large extent on the number of applications for derogations that had to be dealt with. The greater the number, the greater the risk of inconsistency in the decisions taken. The number of applications would not of course be within the Government's control. It would depend partly on the tightness with which the limits were drawn (on which see also paragraphs 80 to 85 below), and partly on the nature of the scheme chosen.

77. If rates were frozen and successful applications for derogations led to extra Exchequer grant (as under Schemes A(i) and B(i)), it is reasonable to assume that most authorities would apply, since they would have nothing to lose by doing so.

78. If a derogation entailed a higher permitted rate increase (as under Schemes A(ii), B(ii) and C) it is reasonable to assume that fewer authorities would apply. Some would wish to support Government policy; some would want to avoid higher rates even though they could try to lay the responsibility on the Government. Some might in any event be able to live within their increases. But there would probably be a substantial 'hard core' of very complex cases from local authorities hostile to the scheme, and seeking to disrupt it. Some applications might come from authorities responsible for substantial budgets and

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a wide range of services, eg there were 73 authorities with budgets over £100m in England and Wales in 1982/83, each responsible for upwards of 10 major services. There is no reliable way of estimating the likely number of applications, but on the assumption that the limits were set fairly tightly it would be imprudent to take it for granted that the number would in any case be much fewer than half the total (ie about 200).

79. It would of course be possible to reduce the number substantially by restricting a control scheme to local authorities spending well in excess of their GREs - for example, as in the scheme considered in MISC 79(82)20 whereby a few authorities would be selected for scrutiny and a limit placed on the rate increases those authorities were allowed to make. But such schemes appear to fall outside the Group's terms of reference, which concern all authorities.

D PUBLIC EXPENDITURE AND EXCHEQUER GRANT

(i) Public expenditure

80. The level of actual local government revenue expenditure achieved under the control scheme would be powerfully influenced by the levels of planned expenditure provided for by the Government in the "reasonable budgets" or expenditure assumptions for individual local authorities, the amount of grant provided, and the levels of permitted rate increases in the rate increase limitation schemes.

81. For schemes involving permitted rate increases (A(ii), B(ii) and C), it was suggested in paragraphs 44 to 49 that the Government's public expenditure plans for local government services would have to reflect estimates of actual expenditure in the preceding year, in order to minimise the risk of successful legal challenge to the control limits. This does not in itself imply higher public expenditure than would otherwise be the case, but it may imply higher figures in the published expenditure plans.

82. The higher the permitted rate increases under Schemes A(ii), B(ii) and C the less the pressure there would be on lower spending authorities to rate and spend well below average levels. Experience when English authorities (in 1982/83) were allowed to treat the higher of GRE or their 'expenditure target' as the 'penalty free' level of expenditure suggested a tendency for authorities to take advantage

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of any headroom available to them, but this could be offset to some extent by reductions made by the higher spenders.

83. But the lower the initial 'reasonable budgets', grant and permitted rate increases, the greater would be the constraints on actual local government revenue expenditure; but the larger would be the number of applications for derogation and the greater the risk of successful legal challenge.

84. On balance the Group consider that while a control scheme based on a freeze on rates should eliminate rate increases, and one based on rate increase limitation should block off very high rate increases, it is not self-evident that such control schemes would secure lower aggregate expenditure than if the current block grant system were applied with rigour. Moreover, the more weight that Ministers give to the need to minimise the number of derogation applications and the risk of legal challenge, the more headroom they will need to give in terms of reasonable budgets, amounts of Exchequer grant, and size of permitted rate increases; and the greater the headroom, the higher the expenditure that a control system will permit. No scheme avoids this problem, although Scheme C would not give additional headroom to those authorities in a position to hold or to cut rates whereas schemes A and B which involve uniform rate limits or a rates freeze, would. On the other hand the block grant system alone cannot eliminate rate increases, or constrain their size, in the way that a rates control could. With block grant and no control scheme, a local authority is free to increase expenditure if it chooses to pay the price in loss of grant and higher rates; and/or to increase rates for other reasons such as building up balances in non-election years.

85. The Group have recommended in paragraph 58 above that no specific counter-action should be taken in respect of higher expenditure financed by increased charges, fees and rents; or by running down balances. The former would not increase net public expenditure, since such income is netted off gross expenditure. The latter would increase public expenditure to the extent that they are used up over time, but the sum at risk is relatively small - £500m or 2½% of current expenditure in England and Wales.

(ii) Exchequer grant

86. If rates were frozen, or if rate increases were kept below the rate of increase in local authority expenditure, more Exchequer grant would be needed.

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The amount of extra grant needed would depend on a) the increase in expenditure and b) the nature of the limit on rates. It would also take into account the fact that, even with frozen rate poundages, rate income would continue to grow at about $1\frac{1}{4}\%$ a year, as a result of the underlying growth in rateable value.

87. Annex G sets out some detailed figures, on various assumptions, for both the interim and the final schemes. A basic illustrative assumption is that expenditure increases at 5% a year from 1984/85 onwards. The main subordinate illustrative assumption is that in the case by comparison with which the extra grant is calculated AEG also increases by 5% a year; in other words, the grant percentage remains constant. (The Group makes no policy assumption about an appropriate level of grant).

88. On that basis, if rate poundages in 1985/86 were reduced to the 1983/84 level and frozen there, then in 1987/88, the last year of the interim period, £2.3 billion more grant would be needed than if rates had been allowed to increase in line with expenditure. If however rate poundages in 1985/86 were reduced to the 1983/84 level and then allowed to rise at $3\frac{1}{2}\%$ a year throughout the interim period, no extra grant would be required in 1987/88 since the annual increase in the rateable value base would make up the difference, provided that there was no fundamental valuation change which would affect the rateable base.

89. The comparisons would be different with different assumptions about the annual increase in expenditure. If for example, expenditure rose by 8% a year, then rate poundages would have to rise by over 6% a year if increases in the grant percentage were to be avoided. Smaller increases in rate poundages would mean that the grant percentage would have to be increased. This is shown in the following table; which shows the increase in the annual changes in percentage compared with a constant grant percentage, for different combinations of a) annual increases in expenditure and b) annual increases in rate poundages.

| | <u>Increase in expenditure</u> | | |
|---------------------------|--|-------|-------|
| | 3% | 5% | 8% |
| Increase in rate poundage | <u>Annual change in grant percentage</u> | | |
| 0% (rate ceiling) | +0.8% | +1.6% | +2.7% |
| 3% | -0.6% | +0.3% | +1.5% |
| 6% | -2.0% | -1.0% | +0.3% |

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Each percentage point on the grant percentage represents between £300m and £400m (depending on the growth in expenditure). With a 5% growth in expenditure, the initial cost in 1985/86 of reducing rate poundages to their 1983/84 levels would be an increase in grant of about £1.2bn compared with holding the grant percentage constant at the 1984/85 level. It can be seen from the table by 1987/88, the cost would have increased by £1.1bn (approx $1.6 \times 2 \times £340m$) to £2.3bn. With an 8% growth in expenditure, the initial cost would be about £2bn, increasing by another £2bn (approx $2.7 \times 2 \times £375m$) to £4bn in 1987/88.

(iii) National Taxation

90. Additional Exchequer grant would imply higher national taxation. The £2.3 billion cost in 1987/88 of a rate ceiling at 1983/84 levels would be equivalent to 2 percentage points on the National Insurance Surcharge, about 2p on the basic rate of income tax, or about 3 percentage points on the national VAT.

E TRANSITION

91. Since proposals would have to be announced well before April 1984, authorities would have an incentive to rate up in 1984/85, so as to have balances in hand when the control scheme came into operation. However, increased rates for the express purpose of pre-empting the control scheme could be vulnerable to legal challenge on the ground that this was not consistent with the reference to contingencies in the General Rate Act 1967. The tendency to increase rates in 1984/85 might also be limited in practice:

- (a) by the fact that the GLC, shire and metropolitan counties face elections in 1985;
- (b) if it were made clear well in advance that the size of balances would figure in the assessment of applications for derogations;
- (c) if the control scheme reflected an explicit or implicit 1983/84 baseline (see paragraphs 28-30 above).

There is also the possibility that authorities determined to embarrass the Government would rate low in 1984/85, with the intention of leaving themselves unable to meet their financial commitments and stay within their permitted rate

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increase for the following year. They might then seek to force large derogations or Government intervention. Alternatively some authorities might decide to rate up and spend up in 1984/85, before the control scheme took effect. But with a rates baseline of 1983/84 announced in advance they could derive no permanent benefit from doing so.

F INTERVENTION

92. Authorities refused derogations or allowed smaller increases than they had asked for would have to reduce expenditure or, in cases where they were determined to seek confrontation, to "become bankrupt". The latter could take various forms, including spending until they ran out of cash to fulfil statutory duties and meet contractual commitments (including payment of salaries and wages to employees.) Councillors would be exposed to the risk of surcharge and disqualification where they acted illegally. But this might not be enough to deter certain authorities.

93. The Group examined three main options for responding to full default by a local authority. These are discussed in detail in Annex H, but in summary are:

- (a) no intervention except in emergencies;
- (b) appoint a Commissioner to run the authority's finances only;
- (c) appoint a Commissioner to take on all the authority's functions.

Option (a) would leave the authority firmly responsible for the breakdown of local services and for dealing with creditors, who might pursue the authority in the courts. But the legal processes for the recovery of civil debts, and local democratic pressures to bring the authority back into line, would work too slowly and uncertainly to prevent events getting out of hand, eg through the breakdown of services widely seen by the public as essential, and the problem of large numbers of employees (perhaps tens of thousands in the larger authorities, including teachers, policemen and firemen) remaining unpaid. The pressure on the Government to act could become irresistible. Option (b) would solve some of these problems by the limited use of a Commissioner who could only exercise the authority's financial powers, including budget and rate-making, borrowing, the letting of contracts and the payment of bills and wages. The Government would be

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kept at one remove. But even this basic range of functions would depend on the active co-operation of some of the authority's staff (mainly in Treasurers' Departments) and the acquiescence of many others and, therefore, the local government unions. Where an authority was determined to maintain its challenge, perhaps with some support from its staff, their unions and the public, a finance Commissioner might be unable to function. Moreover, such a Commissioner would not be able to control the running and delivery of services, some of which the public would regard as essential, if the authority and the departmental staff did not do so.

94. This leads the Group to the conclusion that, in cases of determined challenge through default, the Government would have to be ready, and have available the necessary powers, to appoint a Commissioner to run all the authority's functions and meet its statutory obligations to provide at least the essential services like police, fire, some personal social services, schools and public health functions. A Commissioner in these circumstances would undoubtedly have a formidable task. Even if authorities defaulted on a very limited scale there would be significant implications for central government departments with responsibility for local authority services both in terms of manpower numbers and staff costs, particularly for DOE.

95. Ministers would need to consider whether to provide from the outset for default arrangements as part of the interim control scheme, or to wait for the local authorities' response before deciding whether to take powers. If they wished to make provision at the outset, legislation might be prepared which either (a) set out the detailed machinery for default action or (b) made provision for the Secretary of State to specify default arrangements in an Order subject to affirmative resolution of the House of Commons. There might however be Parliamentary objection to an order making power on such a major issue. The Group do not consider however that there can be any certainty of developing detailed default legislation in time for introduction by January 1984. A possible compromise would be to deal with default legislation in a separate Bill introduced at the beginning of the 1984/85 session for enactment by March 1985, just before the control system would start.

G OTHER ISSUES

(i) Creditworthiness

96. Rate limits would in theory restrict the ability of local authorities to pay creditors, and might make it harder and more expensive for authorities generally to borrow. The markets would certainly expect the Government to step in and prevent the bankruptcy of authorities where this might otherwise follow from the control system. It might be necessary for the Government to state explicitly that it would do so. Uncertainty about the creditworthiness of local authorities would reduce their status as borrowers and add to the burden of interest on their debts.

(ii) Interaction with structural reform of local government

97. If an interim scheme ran for not one year - 1985/86 - but for say 3 years - 1985/86 to 1987/88 - it could interact with any reforms affecting the upper tier of local government. Rate limits would have to be set for successor authorities, whether in place in 1986/87, or in existence in "shadow" form; the base line for calculating the limits would have to be calculated by reference to the expenditure or rates of the bodies being abolished. If there are any new single-service "upper tier" precepting bodies it is probably the case that the budget would have to be determined by central government. Any extra costs arising from reorganisation would also have to be taken into account. Normal boundary changes proposed by the Local Government Boundary Commission would also need to be accommodated. These issues also interact with the possible shape of the final scheme, in particular the question whether a supplementary local tax can be operated by two tiers (see paragraphs 153-166 below).

(iii) Interaction with Metropolitan Police Precept

98. The Metropolitan Police precept is fixed by the Home Secretary. Further consideration will be needed to ensure consistency between the precept and the control of rates overall.

H MANPOWER IMPLICATIONS

99. The Group have not been able to identify a suitable precedent on which to base a manpower assessment. The Scottish experience of intervention and control

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is not a reliable guide because the Scottish office was dealing with only a handful of authorities drawn from a small total number. Scottish Ministers did not have to consult colleagues with responsibilities for services; they were in a position themselves to take an overall view.

100. On the assumption that fewer than 200 applications for derogations are received (ie with a rate increase rather than a rate ceiling scheme, see paragraphs 76-78 above) the Group suggest that DOE might need at least four new administrative divisions and one new legal division. Other professional skills, such as accountancy, might also be required. If each administrative division had three sections headed by a Principal or equivalent, this would imply some 60 staff overall. The staff would need to be experienced and of high quality, in order to ensure fair and consistent decisions and minimise the risk of successful legal challenges. In handling derogations it would be necessary for the Secretary of State to have powers to require local authorities to provide specified information in some detail (eg information on manpower, including wastage and redundancy costs, and other service information; and on finance including balances etc) in addition to any material volunteered by authorities in support of their applications. Other Whitehall departments would probably need at least the same number between them to deal with representations about specific service responsibilities. The Welsh Office estimate that on the same basis they would need about 20 extra staff.

101. Any scheme of control therefore has substantial manpower implications for central and local government - perhaps over 100 experienced and qualified staff in central government Departments in England and Wales and 300-500 in local government, together with heavy additional demands on Ministers and elected members.

I ANNUAL TIMETABLE

102. If the necessary legislation could be in place by July 1984 the timetable for the operation of the interim scheme in the first year could be as follows:

- (i) provisional "reasonable budgets" (if appropriate) and rate poundage freeze/permitted rate increase formulae (as appropriate) set in July 1984 (if necessary before Royal Assent);

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- (ii) preliminary representations received from authorities from September 1984 onwards;
- (iii) RSG settlement and firm rate poundage freeze/permitted increase formulae announced in December 1984 and confirmed by Parliament in January 1985;
- (iv) applications from authorities for derogations (ie frozen rate level adjustments/more grant in Schemes A(i) and B(i); or higher rate levels in Schemes A(ii), B(ii) and C): January 1985 onwards;
- (v) initial rates for 1985/86 set on government limits: February/March 1985 (final rates in cases where authorities accept Government calculations);
- (vi) decisions on derogations (March to (say) September 1985), length of time depending on number and complexity of cases:
 - a) for a rates freeze (Schemes A(i) and B(ii)); in year 1 the granting of a derogation would lead to additional grant being paid as appropriate;
 - b) for permitted rate increases (Schemes A(ii), B(ii) and C); the granting of a derogation would mean either approval for temporary borrowing or a controlled supplementary rate increase;
- (vii) April/May 1985 onwards: authorities not accepting the Secretary of State's decisions on derogations apply to the High Court for judicial review (cases and consequential work will continue well after 1985/86);
- (viii) provisional permitted rate increase formulae announced for 1986/87 (Schemes A(ii), B(ii) and C): July 1985;
- (ix) late applications for 1985/86 derogations continue to come in as unforeseen circumstances arise (to be run into 1986/87 applications once 1985/86 is closed);

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The key differences between schemes which freeze rate levels and permitted rate increase schemes are set out in (vi) above. The timing considerations are broadly the same except:

- (a) more applications will be received in the first year for schemes which freeze rate levels (see paragraph 77);
- (b) the first year for such schemes will probably require additional staff effort to determine each derogation because of the "final" nature of a frozen rate poundage.

J SCOTLAND

103. This section describes proposals for changes in Scotland parallel to those proposed earlier in the Report for England and Wales but taking account of Scottish circumstances.

(i) Local government Structure and Finance in Scotland

104. Local government organisation and functions in Scotland are described in Annex B.

Performance since 1979

105. Since the Government took office it has sought to control and reduce local authority expenditure in Scotland by a policy of general pressure on grant levels and selective action against individual authorities. General pressure has been applied by reducing Aggregate Exchequer Grant as a percentage of planned expenditure. For 1979/80 AEG was 68.5% of relevant expenditure. For 1983-84 the percentage is 61.7. In addition general abatements of grant have been made in specific years to bring further pressure to bear on local authority expenditure.

106. The Secretary of State for Scotland has also taken powers in the Local Government (Miscellaneous Provisions) (Scotland) Act 1981 and the Local Government and Planning (Scotland) Act 1982 to enable him to take selective action against individual high spending authorities. These powers were used in

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both 1981 and 1982 to achieve guaranteed expenditure reductions among certain individual high spending authorities. In 1982 the use of the power led to a rate reduction of 16% in Lothian Region and almost a halving of its planned expenditure excess. Action against another authority (Stirling District Council) led to a substantial reduction in its planned excess and a freezing of its rates at the level of the previous year.

107. In Scotland as in England other measures have been taken to increase local government accountability. A Code of Practice has been issued on the Publication of Manpower and Financial Information. A mandatory accounting and competitive regime has been established for direct labour organisations. Encouragement has been given to the contracting out of services to the private sector. The Commission for Local Authority Accounts in Scotland (established in 1974) has carried out a number of value for money studies in co-operation with local authorities.

108. Annex C(ii) shows how expenditure and manpower have changed in Scotland since 1979 (with a longer term comparison with the mid-1970s). It also shows the rate increases and rate of inflation experienced by local government over the period.

109. Manpower has fallen by 4.2% since its September 1980 peak. Individual high spending authorities have been brought back into line. The rapid increases in rates which took place in 1980/81 and 1981/82 have now been replaced by smaller rate increases for 1983/84; the average increase is 2%. For 1983/84 planned overspending in Scotland will have been reduced from almost 8% in 1982/83 to 4.6%.

Income and expenditure

110. In 1982/83 the estimated gross revenue expenditure in Scotland of local authorities is £4.2 billion. This is expected to be financed by:

| | |
|-----------------------------------|-----|
| Government grants | 46% |
| Domestic rates | 11% |
| Non-domestic rates | 21% |
| Rents, fees and charges | 19% |
| Other income (including receipts) | 3% |

111. Local government expenditure is supported by:

- (a) Specific grants (£166 million in 1982/83);
- (b) Domestic rate relief which reduces the local general rate by 3p in the £ (£14.1 million in 1982/83);
- (c) Rate Support Grant (£1620 million in 1982/83 after grant abatement).

112. In Scotland there is no block grant system. Aggregate Exchequer Grant (AEG) is paid by way of specific grants and rate support grant consisting of domestic, needs and resources elements. AEG is calculated with reference to the Government's expenditure plans for local government services for the year but apart from specific grants is paid as an unhypothecated sum in aid of authorities' net revenue as a whole. Local authorities remain free to determine their own relative priorities between services.

113. The needs and resources elements of rate support grant are distributed so as to compensate for differences in spending needs and to equalise rateable resources between authorities. The aim is to enable authorities to provide the same standard of service for the same rate poundage. This requires large amounts of grant given the present differences in resources and needs in Scotland. In 1983/84 about £216 million is to be spent on resource equalisation and £1514 million on needs equalisation. Without compensation for the difference in needs, rate burdens across the country would change dramatically.

(ii) Interim arrangements for control of Rates and Rate Support Grant in Scotland

114. This section deals with the interim period in Scotland from 1985/86 until the new local tax is in operation. It looks at the two options of (a) a freeze of rate levels (which does not rule out the possibility of rates going down) and (b) strict control over annual rate increases. It assumes that any deficit between frozen or controlled rate income and acceptable total net expenditure by local authorities will be met by increased rate support grant.

115. The interim scheme would require legislation on the same timetable as that for England and Wales (introduction in January 1984, enactment summer 1984) to enable it to be implemented by April 1985.

Description of Schemes

116. Three possible schemes for controlling rates in Scotland are offered. Two are based on existing rate levels, in the third, rate levels would be controlled at one remove through control of grant and expenditure. The first would involve a substantial change to a deficit grant system. The second and third would retain the present equalising system of grant distribution. The first two schemes could take two main forms (although it is possible to construct other variants), one in which rates are frozen, the other in which a limitation is put on increases. Under the third a rate level would emerge for each authority to fill the gap between grant and permitted expenditure. Under all the schemes it would be necessary to approve expenditure levels for each authority, explicitly in I and III, implicitly in II. Such a step has not hitherto been taken in Scotland: but the construction of approved expenditure levels would be feasible on the basis of client group assessments of expenditure need which underly the current expenditure guidelines, which are issued each year by the Scottish Office. This method has been much criticised by the Convention of Scottish Local Authorities and individual authorities, although they are now cooperating in its improvement. The schemes are as follows:

I (a) and (b)

This scheme corresponds to A in the section on England and Wales. Rates would be either (a) frozen or (b) allowed to rise to a percentage or poundage limit placed on annual increases. Individual expenditure levels ("reasonable budgets") would be set for each authority. A deficit grant (replacing RSG) would be paid on the difference between maximum forecast rate income and the approved expenditure level (which could be adjusted to reflect the past expenditure performance of the authority). Rate limits under (b) could be set at varying levels so that the rates of high spending authorities were allowed to rise less. Past performances could be taken as the preceding year's budget judged against current expenditure guidelines.

II (a) and (b)

This corresponds to B in the section on England and Wales. Rates would be either (a) frozen or (b) allowed to rise to a percentage or poundage limit placed on annual increases. Rate Support Grant would be distributed on the existing formula though needs and resources elements with an adjustment in the distribution formula which would have the effect of (a) linking grant in part to past expenditure performance (an innovation for Scotland) so that some selective control would be exercised over individual expenditure levels or with (b) permitted increases in rates could be limited to past expenditure performance.

III

An approved expenditure level would be set for each authority. Rate support grant would be distributed on the existing formula through needs and resources element with an adjustment linking grant in part to past expenditure performance. Each authority's rate would be the amount it needed to raise to bridge the gap between grant and approved expenditure. In outline this is the same as Scheme C in England and Wales but the lack of a block grant system in Scotland means that its outcome would be different. Rates would make up the deficit and thus would have no necessary relation to the authority's present rate. It thus cannot be considered as a direct rates control scheme, as can I and II.

Assessment of Schemes

117. (a) When the Secretary of State grants derogations under schemes which freeze rate levels (I(a) and II(a)) extra grant would be payable. Under schemes subject to permitted rate increases (I(b) and II(b)) additional rate increases would be allowed before the start of the financial year. Otherwise temporary borrowing, to be recouped in a rate increase the following year, would have to be allowed.
- (b) I moves to a new deficit grant system. II and III retain the existing system.

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- (c) All systems equalise needs and resources, II and III through the existing system distinguishing needs and resources, I under a new system of meeting the deficit between local resources and approved expenditure.
- (d) Schemes I and II would control each authority's rate income and Exchequer grant and thus constrain its net expenditure. Income from rents, fees and charges would not be controlled nor would expenditure from balances.
- (e) Under schemes I and II rates would be frozen or permitted rate increases set directly on the basis of general rules for all authorities or classes of authority by reference to actual rate poundages in a base year. Under III an entirely new rate would be set for each authority depending on the gap between grant and expenditure - this rate could be above or below its existing rate.
- (f) In Schemes I and II the frozen rate level or permitted increase would be set in terms of the rate poundage rather than in terms of the bill paid by the ratepayer. If poundages were frozen across the board, the bills paid by ratepayers would be frozen, unless there were a change in the valuation of their property. Under III there could be significant changes in rate bills.
- (g) Schemes I and II have the same starting point - actual rates in a given year. Neither takes account of the extent to which these are affected by local factors and, in particular, by balances, though II(b) could be tuned to performance or local factors. Scheme III produces an entirely new rate.
- (h) Under all schemes expenditure levels would be set by using the client group assessments of need used for guidelines of current expenditure issued at present. There is a strong likelihood of challenge by authorities to expenditure levels set in this way, just as there has been much criticism over the use by the Secretary of State of guidelines.
- (i) Since under all schemes expenditure levels would be set, there would be no scope for using the Secretary of State's existing selective

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action powers which are based on excessive and unreasonable expenditure.

- (j) It is possible under all schemes to make adjustments to reflect expenditure performance. Under I(b) and II(b) permitted rate increases can be linked to expenditure performance.

118. Where rates were frozen and the Secretary of State granted derogations, extra grant would be payable. Under schemes allowing limited rate increases additional rate increases would be allowed. If the limits were too tight, there would probably be a large number of applications for derogations. If the limits were generous, authorities might increase their rates and expenditure accordingly. The range of recent rate increases in Scotland illustrates the problems in setting a limit which will avoid a large number of derogations. In 1983/84 the changes varied from -10p to +16p and from -36% to +35%.

119. Within classes of authorities (regions, islands and districts) there is a very wide range in rate poundages. Poundages vary among the 9 regional councils from 76p to 93p, from 72p to 141p among the three islands councils and from 8p to 61p among the 53 district councils (Annex E(ii)). If rate increase limits were set at a uniform poundage - say 5p - there would therefore be considerable variation at ratepayer level. Percentage increases would give equal headroom to high and low spending authorities. Percentages could be varied to take account of spending performance. So could poundages - but less flexibly. In Scotland as in England and Wales the advantage lies with using 1983/84 as the base year for controlling rates.

Possible local safety valves

120. The safety valves available to Scottish local authorities are generally speaking the same as those available in England and Wales. The main difference is that in Scotland balances are much smaller - about £50 million in 1982/83. This represents 1½% of net current expenditure; the equivalent English and Welsh figure is 10%.

Statutory duties and powers

121. Statute places duties on the Secretary of State and on local authorities for the provision of local services. The possibility of conflict between those duties

and any measures which have the effect of reducing local expenditure must be borne in mind. The Secretary of State has power to reduce payments of rate support grant if satisfied, inter alia, that local authorities have failed to achieve or maintain a reasonable standard in the discharge of any of their functions. He may make regulations prescribing standards and general requirements in relation to local authority functions and have regard to those and any other standards or requirements provided in statute in determining whether there has been a failure properly to discharge a function. None of these powers has been exercised.

122. Powers also exist to make regulations for specific services, eg for the government and administration of police forces and to prescribe standards and general requirements for the provision of schools and education. These powers have been exercised.

123. Details of duties and related advisory functions and regulation making powers are set out in Annex F(ii).

Legal challenge

124. The same considerations apply in Scotland as in England on legal challenge in regard to application for derogation as set out in paragraphs 70 to 79.

Financing increases in expenditure by temporary borrowing

125. Under a rate increase limitation scheme, if a derogation allowed an expenditure increase after the rate had been fixed, there would be a choice between allowing the increase to be financed from temporary borrowing or a supplementary rate. In Scotland there has never been a power to raise supplementary rates and the discipline which the absence of such a power exerts is not to be lightly abandoned. Temporary borrowing is in general more expensive for the ratepayer than a supplementary rate (unless the extra income to be raised is small) and that in itself could exercise restraint.

Applications for derogations

126. There are no special points of principle which would be different in Scotland. The preferred course would be a power for the Secretary of State to

decide whether or not to grant applications for derogations without recourse to Parliament and subject only to judicial review. However, if national percentage or poundage limits were applied, they would almost certainly have different effects north and south of the Border. It would be reasonable for Scottish limits to be different. It is impossible to estimate the number of applications there might be but using the same assumptions as in paragraph 78 there might be about 30.

Expenditure Implications

127. The general expenditure implications are the same for Scotland. High rate increases would be controlled but aggregate expenditure would not necessarily be lower than under present arrangements. Scotland differs in that under present arrangements there is already a selective power to deal with high expenditure in the case of individual authorities by requiring them to bring down their rates. However, unlike England and Wales, there is no power to control the expenditure of authorities generally through losses of grant related to expenditure levels.

Intervention

128. There is a general default power in section 211 of the Local Government (Scotland) Act 1973 but no power to appoint commissioners. The problems of intervention are the same in Scotland. In Scotland the power to surcharge councillors has the same drawbacks - it takes too long to work to be an effective means of ensuring that an authority resumes its statutory duties. In Scotland there is the additional problem that the decision to surcharge has to be made by the Secretary of State on a report by the Commission for Local Authority Accounts in Scotland, and not by the courts on the basis of the Auditor's report, as south of the Border.

Transitional problems

129. There are no major special Scottish transitional problems.

Manpower implications

130. Appreciable extra staff effort, both administrative and legal, would be called for - say one administrative division headed by an Assistant Secretary to

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deal with the legislation and subsequently expanded in order to cope with derogation applications and the interaction of the new tax with the RSG system, and some extra effort in Solicitor's Office - 10-12 staff in all. Another 8-10 would be required in Departments dealing with services to give advice on derogations. No scope can be seen for redeploying existing staff to cover the new workload. Additional staff would also be needed by local authorities.

Annual timetable

131. If the necessary legislation is in place by July 1984 the timetable for the operation of the interim scheme in the first year could be as follows:

- (i) provisional individual authority expenditure levels and frozen rates level or permitted rate increases formula set in July 1984
- (ii) representations from authorities from September onwards
- (iii) RSG settlement and firm frozen rates levels/permitted increase formulae announced in December 1984 and confirmed by Parliament in January 1985
- (iv) Applications from authorities for derogations from January 1985 onwards
- (v) In the case of rate limitation schemes as many applications as possible would be dealt with before the final date for fixing local authority rates (late February/March).
- (vi) Decisions on applications for additional grant (under schemes which freeze rates levels) and for borrowing consent or permitted rate increases (if supplementary rate introduced) dealt with by July.

K ISSUES FOR MINISTERS

132. The Group conclude that it is possible to construct an interim scheme which freezes rates or places a limit on permitted rate increases. Such a scheme must involve arrangements for considering applications for derogations, which would

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have to be decided by territorial Secretaries of State, in consultation with other service Ministers. The Scheme could have implications for Government policies in relation to certain services of national consequence for which local authorities are responsible, since in varying degrees successful implementation of those policies depends critically on the co-operation of the local authorities concerned. The scheme would eliminate or reduce rate increases, but it is not self-evident that it would secure lower aggregate expenditure than if the current block grant system were applied with rigour (paragraph 84).

133. The issues on which decisions are required are set out below. If a control scheme is to be implemented in April 1985, decisions on the form it should take are required very soon. This would permit a public announcement early in the summer, a brief period of consultation, the introduction of separate Bills for Scotland and for England and Wales by January 1984, and their enactment by summer 1984. The same principles could apply to Wales and Scotland, although some differences of detail would be required.

134. The main operational problems which would arise are:

- (i) the risk of successful legal challenge on rejection of applications for derogation (paragraphs 70-79)
- (ii) the risk of the Government being forced to take over a local authority's service if it refused to co-operate (paragraphs 92-95)
- (iii) potential conflict between advice and guidance with expenditure implications given by service Ministers and the indirect constraint on expenditure applied by a rate control scheme (paragraphs 62-65).

England and Wales

135. If Ministers do wish to exercise direct control over rate levels the main prior issue is whether it should take the form of a freeze on rate poundages (that is an absolute limit for each authority related to the rate poundage set in a base year) or a set of limits on increases?

136. If Ministers want a freeze the choice is between:

A(i)
(deficit grant)

B(i)
(block grant operating independently)

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137. Scheme A(i) could be simpler and more comprehensible than Scheme B(i). However, the longer it ran the more difficult it would be to reinstate a block grant system which equalised differences between authorities in needs and resources.

138. Schemes for freezing rates would require more Exchequer grant because authorities would also be more likely to apply for derogations, since they would stand to gain extra grant if they were successful. The more applications, the greater the prospect of successful legal challenge because of the difficulty of ensuring consistency of treatment as between applications. For these reasons, the Group consider that schemes of rate increase limitation (A(ii), B(ii) or C) are to be preferred.

139. If Ministers want a limit on rate increases then the choice is between

A(ii)
(deficit grant as in A(i);
rate increases based on
past actual rate levels)

B(ii)
(block grant, as in
B(i); rate increases
based on past actual
rate levels)

C
(block grant;
permitted rate limits
derived from block
grant entitlement for
spending at
"reasonable budget"
levels)

The choice depends on how far Ministers wish a) to limit rate increases by reference as closely as possible to actual rate levels in a base year; and b) to preserve an equalising grant. Schemes A and B use actual rate levels; Schemes B and C preserve an equalising grant. Scheme C would probably create fewer anomalies between authorities and minimise grounds for derogations.

140. A number of other decisions will need to be taken:

- (i) the base year to use for the frozen rate poundages and/or the rate increase limits. The Group propose 1983/84 but it would be necessary to consider adjustments for the use of such things as balances (paragraphs 28 and 30);
- (ii) whether to allow rates to fluctuate up and down below the limit (paragraph 31);

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- (iii) whether, when setting "reasonable budgets" or permitted rate increase limits under the various options, to "skew" these to allow different implied year on year changes in expenditure for low spending and high spending authorities (eg to reflect changes in expenditure needs) (paragraph 36);
- (iv) whether, if a rate limitation option A(ii) or B(ii) is chosen, to define permitted increases in uniform flat rate poundage or percentage terms. As explained in paragraph 39 the issue does not arise in the case of Scheme C (paragraphs 37-39);
- (v) whether lower tier (parish) precepts should be dealt with by including them in the overall limit for each rating authority; whether to commission further work on the option of setting a uniform limit on the rate poundage of all parish and community councils; (paragraph 42-43);
- (vi) whether, as part of the process of setting "reasonable budgets", the published public expenditure provision should be adjusted accordingly to a level which local government could reasonably be expected to achieve. The Group consider this would be necessary in order to provide sufficient headroom to avoid an unnecessary number of applications for and concessions of derogations, and to minimise the risk of legal challenge. A consequential would then be the "writing off" of any excess over planned expenditure in the year before the control scheme commenced, ie 1984/85 (paragraphs 45 and 81);
- (vii) whether it is necessary to commission a further study of the scope for limiting the use for revenue purposes of specific grants (paragraph 51);
- (viii) whether to agree that no action should be taken to control the various "safety valves" open to local authorities such as rents, fees, charges, fares (paragraph 53), and balances (paragraph 54). As regards balances, the Group's view is that watertight legislation could not be introduced by January 1984 (paragraph 56). But it could be made clear well in advance that the size of balances (eg those

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built up in 1984/85) would be taken into account in deciding applications for derogations when the control scheme began (paragraph 91(b));

- (ix) the form of procedure for approving decisions on applications for derogations; ie separate Parliamentary approval for each case, or a general power for the Secretary of State to decide, subject to judicial review. In view of the potential demand on Parliamentary time, the Group conclude that a general power should be taken (paragraph 61);
- (x) whether, if a control scheme is adopted, it is also necessary to review the advice and guidance with expenditure implications for local authorities issued by service Ministers, to ensure consistency with the control scheme. The Group consider that it is (paragraph 63);
- (xi) whether to provide for temporary borrowing or supplementary rate increases as sources of additional finance where a derogation is granted, or to make provision for either according to the circumstances (paragraph 67-68);
- (xii) whether to provide from the outset for default arrangements, and in what form. The Group consider that the Government should be ready to deal with full-scale default (paragraph 94). It is for decision whether to provide detailed legislation at the outset (probably through a separate Bill) or to provide the Secretary of State with an order-making power. The Group note that legislation would probably not be possible until the 1984/85 session and would hence be available only shortly before a rates control scheme started (paragraph 95);
- (xiii) the content of any statement about local authorities' creditworthiness if control proposals are to go ahead, in order to reassure the money markets (paragraph 96).

141. Of these consequential issues, the Group consider it would be desirable for Ministers to take decisions in principle, along with their main decisions on

rates in the interim period and before any public announcement of proposals, on the following:

i, ii, v, ix, x and xii.

142. The remainder could be decided later and in general would need to be decided before the enactment of legislation:

iii, iv, vi, vii, viii, xi and xiii

Scotland

143. If Ministers wish to control rates they have first to choose between a freeze on rate poundages or a limit on permitted increases.

144. If Ministers want a freeze the choice is between:

I(a) II(a)
(deficit grant) (rate support grant continuing)

While I(a) is simpler, II(a) maintains the present grant system equalising differences between authorities in needs and resources. Derogations under a frozen rates scheme would be made through increasing grant. All authorities would be likely to apply, raising administrative problems and increased risk of local challenge. Schemes of rate limitation are therefore to be preferred (Schemes I(b) and II(b) (paragraphs 116 and 117)).

145. The choice with limits on rate increases is between:

I(b) II(b)
(deficit grant) (rate support grant continuing)

The grounds for choice are similar to those in the paragraph above and the continuance of the present grant system under II(b) seems to make it preferable since, once abandoned, even temporarily for a deficit grant system, it would be difficult to return to it (paragraphs 116 and 117).

146. Similar consequential decisions follow for Scotland (as in paragraph 140 (i)-(xiii) above except v). The only difference is that in Scotland it is also

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for consideration whether under rate limitation schemes (I(b) and II(b)) the level of increase should be related to expenditure performance and used as a mechanism for holding rates down more in high spending authorities.

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IV THE FINAL SCHEME FOR LOCAL TAXATION

147. The object of the final scheme would be:

- (i) to set final ceilings on rate poundages (if not already done in the interim scheme); and
- (ii) to introduce a new supplementary local indirect tax or taxes on expenditure to finance local authority expenditure not met from grants, rates, and other local sources.

148. The major issues are:

- (i) the choice of supplementary tax or taxes;
- (ii) on what basis Exchequer grant should be distributed; in particular whether the present system of compensating for differences in needs and resources ("equalisation") should be retained;
- (iii) whether the level of the supplementary tax or taxes should also be subject to central control.

149. This section considers the issues under the following headings:

- A Local tax options and dates of introduction
- B Local revenue yields required
- C County or district area tax
- D Local sales tax
- E Road fuel duty and vehicle excise duty
- F Comparison of the supplementary tax options
- G Implications for structural reform of local government
- H Rates in the final scheme
- I Equity between local taxpayers and implications for Exchequer grants
- J Central control of expenditure
- K General conclusions

This section refers to England and Wales, but applies in broad terms to Scotland also. Specific Scottish considerations are discussed in paragraphs 167 and 230(j).

A. LOCAL TAX OPTIONS AND DATES OF INTRODUCTION

150. The Group have identified two main options for local supplementary taxes on expenditure: a local sales tax (LST) and a combination of a supplementary local road fuel duty (RFD) on petrol and derv and the transfer to local control of vehicle excise duty (VED) on cars, motorcycles and light vans. Both packages of taxes could be introduced only from 1 April 1988. It would however be possible, as a variant of the second option, to introduce local RFD alone from April 1986, to be followed at a later date by VED.

151. The Group looked also at a third option, a combination of RFD with local supplementary duties on alcohol and tobacco, on which there are at present 12 rates of duty on alcoholic drinks and 4 on tobacco products. But although the yield from such a combination might be enough initially to serve as a supplementary tax, but there are a number of major disadvantages, set out in more detail in Annex M:

- (a) the yield would probably not be adequate to support local government expenditure into the 1990s on the assumptions in paragraph 152;
- (b) the burden of compliance would fall disproportionately on small retail businesses;
- (c) tobacco and alcohol products are already highly taxed, and tobacco products are of particularly high value in relation to weight; this raises major questions of cross-border shopping and evasion, and would lead to disproportionate costs of control and enforcement in relation to around 300,000 retail outlets;
- (d) significant local supplements to the present large national duties would have major implications for overall demand, for national revenue, the levels of output and employment in the industries, and the Chancellor's scope for fiscal adjustments;

There would also be even greater complications in devising an equalising grant with a system of supplementary taxes, including not only property rates and RFD but also all the different alcohol and tobacco duties. The Group consider that this option is not worth pursuing further.

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B. LOCAL REVENUE YIELDS REQUIRED

152. The yields required from supplementary taxes depend upon (a) the date from which rates are frozen, (b) the growth of local authority expenditure in cash terms (which is partly dependent on the rate of inflation) and (c) the level of Exchequer Grant (AEG) support. The table illustrates a range of possibilities:

SUPPLEMENTARY TAX REVENUE REQUIRED IN 1993/94

| Rate poundages frozen at 1987/88 levels | Local expenditure increase from 1983/84 | | |
|---|---|--------|--------|
| | £bn cash (£bn 1983/84 price terms*) | | |
| | 1% pa | 5% pa | 8% pa |
| (i) AEG Growth Rate Equal to Expenditure Increase Yield required 1993/94 | Nil | 4½(2½) | 9(4½) |
| (ii) AEG Growth Rate 2% pa Lower than Expenditure Increase Yield required 1993/94 | 1½(1½) | 7(4½) | 12½(6) |

NOTES: At 1983/84 price levels a LST of 1% would yield £1¼bn to local authorities, a VED of £1 would yield £17½m and a RFD of 1 p per gallon would yield £75m.

*Assumes general inflation equal to the annual percentage increase in local expenditure (in cash). Further assumptions are set out in Annex G.

In the first year of supplementary tax, a revenue of up to £1bn would be required. If rates were frozen at 1985/86 levels up to £3bn (which is reached with an 8% per annum expenditure increase) would have to be added to the cash figures in the table. If rates were to be frozen at 1983/84 levels, and grant allowed to rise until 1987/88, somewhat less supplementary revenue would be required unless it were decided to recoup the additional rise in grant between 1983/84 and 1987/88.

C. COUNTY OR DISTRICT AREA TAX

153. The new supplementary tax needs to be compatible with whatever structural

revision of local government may be undertaken. Each of the options considered below could continue to operate if the GLC and metropolitan counties were abolished. The tax must also be capable of supporting the uneven pattern of distribution of expenditure between tiers of local authority. The main spending tier in the shire areas is the county council, and in the metropolitan areas the districts and London boroughs.

154. The options discussed below are:

- (i) District area tax: each county and district to be able to levy its own variable rate of supplementary tax; this option comes closest to the requirement set by Ministers (E(LF)(83) 1st) to look for indirect supplementary taxes with the same general application as the rates.
- (ii) County area tax: a single rate of tax to be levied in each county area, following consultation between the upper tier authority and the constituent districts.
- (iii) Main spending tier: the new supplementary tax to be available only to the main spending tier in each area with the other tier retaining either complete rates freedom or the power to increase rates subject to the controls discussed in Section III.

(i) The District Area Tax:

155. The simplest arrangement would be to allow each county and district to levy its own rate of supplementary tax, the total tax rate charged in each district being the composite of the rates charged by the upper and the lower tiers. Each authority would retain the yield of the tax rate which it set.

156. Alternatively, counties could determine their requirement for income from the supplementary tax in cash. Each district might be required to raise a portion of that amount from the supplementary tax. The relative shares might be determined in proportion to the districts' GREs, or by population or by some other appropriate formula. This would mean that counties would have certainty about their income from supplementary tax. But the district would need to hedge still more against the uncertainty of the tax yield. This arrangement would be

radically new, and would affect the arrangements for exchequer grant. The perceptibility of the county element of the local tax rate would be very low, damaging accountability. This variant is not further discussed.

157. The district area tax option would:

- (a) require a separate tax base to be defined for each district;
- (b) involve the possibility of a composite rate of tax in each district;
- (c) permit a wide range of tax rates within each county area as well as between county areas.

In any district there might be either a composite rate of supplementary tax (if both county and district were levying the supplementary tax), a single rate of supplementary tax (if only one of the tiers were levying the supplementary tax), or no supplementary tax (if both tiers were spending within the amount permitted by the rate ceiling). The second and third of these possibilities would be unlikely.

158. In practice some convergence of tax rates within each county area might be expected to occur, as a result of market forces and the desire of the district authorities to avoid variations in tax rates which would encourage cross-border shopping and distort the natural patterns of trade. It is impossible to predict how much convergence there would be, nor over how long a period. It would be limited by the varying spending patterns of the authorities concerned, by the varying rate ceilings, and by variations in the size of the tax base at local level, in so far as these variations were not compensated - or were only partially compensated - by Exchequer grant (on which see paragraphs 239 to 262 below). In the short run, at least, some disruption of trade seems likely, especially for large consumer items and petrol. And the fear amongst traders of potential disruption is likely to be widespread. The problem of cross-border shopping is greater for the district area tax option, since authority boundaries (ie tax zone boundaries) are by definition closer together than for counties. It would be most acute in the metropolitan areas and Greater London, and in districts adjacent to them.

(ii) The County Area Tax:

159. The potential for disparities in rates of local supplementary tax and hence the cross-border problem might be reduced by providing for only a single rate of tax to be levied in each county area. In order to give both the county and the districts some responsibilities for determining the tax rate, it would on this approach be set through joint consultation.

160. This arrangement could in theory take either of two forms. Version A would require a separate tax base to be defined for each district area, as under the district area tax. The county would levy whatever rate of tax it needed for its own purposes; in addition the districts would each levy a rate of tax determined by the district with the greatest need for supplementary revenue, each district retaining its local yield. The total rate of supplementary tax would be a composite of the two rates. For example, if the county needed a 2% tax it would levy it throughout the county area; if one district needed a 4% tax, while all other districts could get by with 3%, the district component would be 4%; the total tax rate in the area would be 6%.

161. Under Version B, a separate tax base would not be defined for each district area. Instead there would be rules - which would need to be prescribed in the legislation - for sharing the yield of the supplementary tax between the authorities in a county area. For example, it might be apportioned in relation to each authority's GRE. The county wide tax rate would then be set through joint consultation, as in Version A, except that the county wide rate would be determined by the authority (county or district) with the greatest need for supplementary revenue. For example; if one authority needed a 6% rate of tax - on the basis of the apportionment formula - to supplement its yield from property rates, while all other authorities could get by with less, then 6% would be fixed as the county wide rate.

162. The effect in either version would be to give some authorities in a county area more revenue than they needed to finance their spending, were their property rate to be set at the frozen level. Such authorities would be able to reduce their property rate, provided that the county wide supplementary tax rate was declared before authorities fixed their property rates. It would be possible for a low spending authority to receive more revenue from the supplementary tax than

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it required even with property rates reduced to zero. In some cases the authority might choose to pay a dividend to its ratepayers instead of collecting rates from them.

163. The county area tax would have some advantages:

- (a) the number of cross-border differences in tax rates would be much smaller, and the risk of distortion of markets and disruption of businesses would therefore be much less, especially in the densely settled areas;
- (b) it would not be necessary, under Version B, to define a tax base at district level. This would reduce the administrative costs of the scheme.

164. But there are major objections to this approach:

- (a) there would be much less local accountability for the supplementary tax. Most authorities would find that their rate of supplementary tax was effectively determined by the spending decisions of another authority. The tax rate in outer London boroughs could be that set by individual inner London boroughs;
- (b) the county wide rate of supplementary tax would give some authorities more revenue than they needed. This could lead to additional and unnecessary expenditure, unless an effective system could be devised for requiring a reduction in property rates in such circumstances. This would probably imply a detailed system of control, even more complicated than that described in section III (since to be watertight it would require a statutory definition of an authority's accounts, to ensure that surplus revenue fed through directly to a reduced rate poundage);
- (c) the consultative procedures would involve authorities of perhaps widely differing political views and policy perceptions, and negotiations would need to be completed before the property rates were set. The system would be vulnerable to delay and breakdown;

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- (d) an equivalent to the county level (ie consultative) approach could operate in London and the metropolitan areas if the upper tier authorities were abolished and replaced by single-service bodies with powers to raise local revenue. But it would seem particularly artificial in such circumstances.

(iii) Supplementary tax for the main spending tier only:

165. Under this option only the main spending tier would have access to the new tax or taxes; ie the shire counties, the metropolitan districts and the London boroughs. This option is not strictly within the Group's remit (see paragraph 154(i)). But it is worth considering briefly, since it would avoid the considerable complications of the alternatives of introducing one or more new local supplementary taxes for both tiers, whether operated at district or county level. The main new complication is the effect on the property rates on authorities in the minor spending tier. Unless they could permanently live within their frozen level of rates or precept, which is unlikely, the shire districts and upper tier bodies in the metropolitan county areas and in London would have to increase their rate demands each year, presumably under a continuation of the Section III control scheme (including the derogations procedures). (The alternative would be to give extra Exchequer grant). The ratepayer effect might be reduced to the extent that the main spending tier raised enough by way of supplementary tax to reduce its own property rate. But there would still be the presentational problem that some authorities, the numerous shire districts and the metropolitan upper tier precepting bodies, would in practice be allowed to increase their rates year by year indefinitely, even if only by a controlled amount, and would continue to rely on the rates as their only local revenue. Moreover, this option would not help reduce the problem of cross-border shopping where it would occur most acutely; in the metropolitan districts and London boroughs.

(iv) Conclusion:

166. The Group consider that an independently variable tax for all authorities (ie the district area tax) comes closest to the prime objective of providing an effective supplement to the present rating system which can progressively provide a greater share of the local revenue. Its biggest disadvantage is the instability

of revenue, and the threat, real and perceived, to businesses (particularly to those selling high value consumer goods and road fuel) due to cross-border shopping.

(v) Options for Scotland

167. The structure of local government in Scotland is different from that in England and Wales with (apart from the three all purpose island authorities) two tiers - regions and districts. Within the two tier system the same options for the final scheme apply as described above for England and Wales. In particular:

- (a) each region and district could set its own area rate of supplementary tax, as at present with property rates; or
- (b) a single rate of tax could be set by each region with revenue distributed to districts either on the basis of the district's own tax base or according to some central formula (eg guidelines); or
- (c) the new supplementary tax could be made available only to the regions, with the districts retaining complete freedom to levy property rates.

168. It follows that the same considerations would apply for the two tier areas of Scotland which are discussed for England and Wales in paragraphs 155-165 above, and option (a) therefore comes closest to the objective of providing a supplementary local tax which can progressively provide a greater share of local revenue. Its major disadvantages are those set out in paragraph 166.

D. LOCAL SALES TAX

General

169. The following paragraphs outline the options for a LST as the supplementary tax. A fuller description is at Annex I. No other country which operates a national VAT attempts to operate it in combination with a LST, although some other countries, notably the USA and Canada, operate LST at low rates without a VAT. Foreign practice is described in Annex J.

170. As regards the law of the European Communities, the Law Officers have advised that LST appears to be compatible with Community requirements. But they also consider that if a case challenging the legality of LST were eventually to come before the European Court, the Court would be likely to be particularly influenced by the views of the Commission, and it might therefore be advisable for the Government to seek the views of the Commission before taking a final decision to introduce LST. This could reduce the risk of an adverse ruling leading to the Government having to make large-scale repayments of tax subsequently found to have been collected illegally. The Group's view is that if proposals for the various tax options in the final scheme were put forward on a consultative basis it would be possible to include this as part of the process leading to a firm decision to proceed with LST. There is the possibility that an adverse reaction from the Commission might call in question the feasibility of LST, which is an argument for basing consultation on at least one other supplementary tax option (eg RFD and VED). If the Commission were consulted, it would be advisable at the same time to seek a derogation from the EC to allow VAT and LST to be charged on a mutually exclusive basis to minimise the calculations required of traders (see paragraph 189 below).

Models

171. Two possible models for a single stage sales tax were identified in paragraph 5.4 of the Green Paper:

Model 1 Tax administered by Customs and Excise under national rules of coverage; local authorities free to set the rate (possibly within limits fixed by Parliament).

Model 2 Tax collected and administered by the local authorities themselves, possibly with the power to determine which goods and services should be taxable.

Paragraph 8 of E(LF)(83)2 suggested that Model 1 should be the front runner. The Group have so assumed, because it would be simpler, cheaper to administer and would enable central government to determine the tax coverage. The Green Paper rejected the option of allowing lower-tier authorities to set independent rates of LST on the grounds that it would be disproportionately costly both for the tax collecting agency and for traders (especially multiple traders). The Group suggest that this view should be reconsidered.

172. Since non-domestic ratepayers would benefit as much as domestic ratepayers from limits on rates, the Group conclude that LST should apply in general to business purchases, but exclude both goods for resale and, if problems of definition could be overcome, probably capital goods, semi-manufactures and components (paragraph 15 of Annex I).

Yield & RPI

173. A 1% LST, with the same coverage as VAT but levied both on final consumption and on business services, would yield about £1½bn for local authorities, in 1983/84 price levels. There would be offsetting losses to Exchequer revenue of about £½bn mainly because demand for taxed goods falls as the total tax rate rises. If authorities levied property rates at their ceilings, the average rate of LST theoretically required could be in the range 2% to 3% by 1993/94 on the assumptions in paragraph 152. This would be in addition to the national rate of VAT. In practice the actual average LST rate would be slightly above this level, since authorities would tend to round their tax rates up in order to minimise the risk of shortfall. The effect of rounding would depend on the size of the "steps" in which the tax could be varied (see paragraph 189). If authorities chose to levy property rates below their ceiling, rates of LST could be correspondingly higher. Local rates of LST would vary widely round the actual average.

174. A supplementary tax in place of an increase in rates with lost Exchequer revenue restored by national indirect tax increases might produce a very small addition to the RPI spread over several years. The main effect would be neutral; one indirect local tax would replace another which has similar effects on prices. However, part of the present burden of non-domestic rates is thought to be borne by businesses and landlords rather than passed on in higher prices. With LST or another supplementary local tax, more would be expected to be passed on to the customer.

Fiscal implications

175. Increases in indirect taxation would not be incompatible with the Government's fiscal strategy, but the Group noted that in practice the introduction of LST could lead to problems of fiscal management. Although as explained in paragraph 173 the average LST rate would not be much above 2% - 3% into the 1990s, a combined VAT/LST rate several points above the present 15%

national VAT rate would raise prices and reduce demand for taxed goods and services. It would be bound to restrain the freedom of future Chancellors in relation to changes in VAT rates and structure. The taxation of business services etc would be highly perceptible to the business sector. In the field of final consumers' expenditure it might become more difficult to maintain the levying of both VAT and LST on one-half of consumers' expenditure while the rest remained zero-rated or exempt. There could also be increased pressure for additional reliefs from the many sectional interests who consider that the present 15% rate of VAT is already too high.

Gainers & Losers

176. Each 1% average rate of LST substituted for the equivalent rate yield would result in a direct shift of up to £½bn of tax burden from the non-domestic ratepayer to private households. Further, rates are rebated for poor households but LST is not. The overall effect would be to produce more losses than gains for private households. The table below shows the likely distribution of gains and losses, in terms of changes in personal disposal income, for each 1% rate of LST. It assumes that the burden of rates on the non-domestic sector is not at present passed on to final consumers, whereas the burden of LST on businesses would be (these are extreme assumptions - see paragraph 174). It also assumes that any loss of Exchequer revenue resulting from the introduction of LST would be made good by a corresponding increase in the rate of national VAT. These are therefore maximum estimates of losses. The effects might be expected to be spread over about 2 to 5 years.

HOUSEHOLD GAINS AND LOSSES FROM 1% LST, RAISING £1½bn

| <u>Changes as % of disposable income</u> | <u>% of Households (E&W)</u> |
|--|----------------------------------|
| LOSS More than 6% | 0.2 |
| 3% to 6% | 1.0 |
| 1.5% to 3% | 5.4 |
| 1.5% loss to 1.5% gain | 93.0 |
| GAIN 1.5% to 3% | 0.3 |
| 3% to 6% | 0.1 |
| More than 6% | - |
| (Average change; p per week) | 73p) |

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177. The percentage losses would be greatest for the 3 million or so households on Supplementary Benefit (SB), whose rates are now paid for them. If no adjustment were made to SB, their average loss (53p per week in 1982/83) would under 1% of their disposable incomes. Whether or not there was any adjustment to SB, accountability would be increased in that the tax burden on these households would vary with increases or decreases in local expenditure. For households not in receipt of SB the effects would be smaller. Losses would tend to be greater for large families than for small. Apart from these cases, there would be no marked effects on the distribution of income.

178. The total number of individuals directly paying the supplementary tax would be about 40 million adults plus a substantial number of children, compared with the present 20 million or so domestic ratepayers.

179. Within England, some of the local tax burden would tend to shift from London to the rest of the country. This is because equalisation of rate poundages between London and the rest of England, combined with high London rateable values, results in rate bills in London which are high relative to the amounts Londoners pay for the goods and services which would be covered by LST. This shift of tax burden could, if Ministers wished, be reduced by adjustments to the Exchequer grant distribution.

Timetable

180. Customs and Excise have taken the view that 1 April 1988 would be the earliest date for the introduction of a Model 1 LST. The immediate priority is the current programme for the replacement of the main VAT computers, which is essential in order to safeguard the revenue. This, together with the complexities involved in combining LST and national VAT systems, would prevent an earlier start. It is unlikely that a model 2 system could be introduced any sooner. Such a date would mean that introduction would probably coincide with or follow the abolition of the GLC and Metropolitan counties. This might reduce but would not eliminate such transitional problems as the allocation of local tax yields to successor bodies.

Manpower

181. A model 1 LST would require between 2000 and 3000 extra staff for Customs and Excise, for collection and enforcement. About 1100 would be needed at the VAT

headquarters in Southend, the rest in local offices. Some small addition to staff numbers would be needed elsewhere in central government. Local government would need far fewer extra staff, perhaps several hundred in all, as they would have to estimate the local yield and fix the local rate. The total administrative cost of the scheme might be about £40m-£60m at 1982/83 prices, additional to the present costs of rate collection of £156m (GB).

Compliance

182. The Group conclude that the same registration threshold should be adopted as for VAT (currently £18,000). The scheme would then apply to up to 1 million businesses but would exclude some hundreds of thousands of very small businesses which would otherwise make only a very small contribution to the revenue and in many cases would not be well equipped to cope with the accounting burdens of LST. At the same time it would have to be recognised that exclusion from LST would increase the competitive advantage such very small businesses enjoy by comparison with others above the threshold, which would be obliged to register for LST as well as for VAT.

183. The introduction of LST would result in a substantial addition to compliance costs on top of those incurred under the present system of rating and VAT. As with VAT, the burden of compliance costs would fall most heavily on smaller businesses particularly those just above the registration threshold. The extent of the additional compliance burden which would be imposed by LST cannot be estimated reliably.

Enforcement

184. Collection and enforcement would be the responsibility of Customs and Excise (paragraph 171 above), but the costs would be recovered from local authorities.

Cross-border shopping

185. Cross-border shopping could be a significant consideration. The development of hypermarkets and regional shopping centres, in conjunction particularly with the motorway network, has led to an irregular pattern of major retailing outlets in or near urban areas. This would lead to distortions in the yield of a sales tax to individual authorities which might have to be compensated for by

complicated adjustments to Exchequer grant. There would also be a risk of diversion of trade to areas where the tax was low. These factors could produce a tendency for tax rates to converge over time.

186. It might also be difficult to identify the correct tax rate for some classes of trader, eg service traders operating across local authority boundaries or mail order firms. Mail order firms would have an incentive to site themselves in low tax areas in order to secure a pricing advantage in relation to multiple stores and other traders in high-tax areas.

Perceptibility

187. LST would be less perceptible as a local tax than rates. With a district area tax, the multiplicity of tax rates within each county area could be confusing to the public. Traders might be required to display notices giving details of the various LST rates currently in force in their area but this could add an unacceptable additional burden of compliance costs on traders and businesses. However, it might help to improve perceptibility to require authorities to write annually to each household to explain their rate of tax.

Frequency of changes in tax rates

188. Any change in the rate of tax presents problems for business, both in the uncertainty it causes and in additional work; stock repricing and computer reprogramming, for example. To minimise the disruption, the Group consider that local authorities should not be able to vary their local sales tax rate more than once a year.

"Steps" in tax rates

189. Paragraph 5.21 of the Green Paper suggested that local authorities should be allowed to charge tax in steps no smaller than 1%, in the light of the problems which many smaller businesses experience in accounting even for VAT, which has normally been charged in whole percentage points. Whole point changes would also be clearer for taxpayers. But such large steps would pose severe budgetary problems for authorities because of the lumpiness of the tax yield (eg at a 3% tax rate a change of one percentage point in the rate would change the tax yield by as much as a third). It would also add substantially to the difficulty of

retaining the concept of resource equalisation between authorities (paragraph 249). Whether rates could be allowed to vary by steps of 0.1%, in an age when pocket calculators are widely available, might be made an issue for consultation. To ensure that steps were no less than 0.1%, it would be necessary for VAT and LST to be charged on a mutually exclusive basis. This would require a derogation from the EC (paragraph 170).

Points for Consultation

190. The Group have reached the following provisional conclusions about the detailed operation of an LST scheme based on paragraphs 169 to 189 above and Annex I, which might be included in any consultation document:

- (a) it should be a single-stage tax;
- (b) its coverage should be determined nationally, and should apply to the same range of goods and services as VAT at the retail stage;
- (c) it should extend to business services, but not to goods for resale;
- (d) exports should as far as possible be exempted;
- (e) imported goods should be charged at the point of sale like goods produced domestically (any charge on non-finished goods should be compatible with the postponed accounting system for VAT on imports);
- (f) the registration threshold should be the same as for VAT (currently £18,000);
- (g) the operational problems for Customs and Excise and for traders need to be balanced against the case on financial and Exchequer grant grounds for allowing the tax to increase in 'steps' of less than 1%, say to a minimum of 0.1%;
- (h) rates should be changed no more than once a year;
- (i) administration and enforcement would be by Customs and Excise and the costs recovered from local authorities;

- (j) traders would be required to make returns quarterly identifying separately each district authority area in which they trade;
- (k) for reasons of perceptibility, traders might be required to display LST rates and local authorities might be required to send to householders an annual notice of the LST rates to be in force in the coming financial year.

E ROAD FUEL DUTY AND VEHICLE EXCISE DUTY

General

191. The second option, which could yield the £4 bn a year (at 1983/84 prices) which might be needed by 1993/94 (on the basis of 5% annual growth in expenditure and the other assumptions in paragraph 152) is a supplementary Road Fuel Duty on petrol and derv (RFD), either alone or more promisingly in combination with a transfer to local authorities of Vehicle Excise Duty (VED) on cars, light vans, and motor cycles. The Group have assumed that the Government would retain VED on lorries, since it is an instrument of national transport and fiscal policy. (The Green Paper ruled out RFD and VED as alternatives to domestic rates; RFD on the grounds that it was impracticable, and VED because of the problems of accounting, accountability, control and enforcement. But the Group consider that they merit consideration as possible supplementary taxes since in combination their potential yield is of adequate size and they are taxes on expenditure.)

Road Fuel Duty (RFD)

Models for a RFD

192. Possible models for RFD are fully described at Annex K. At present the national RFDs are charged at a relatively small number of duty points (about 220 nationally) such as refineries. A local RFD would instead need to be collected at the retail stage, so as to enable each authority to retain the revenue collected in its area. It would therefore be necessary to collect the duty from about 25,000 petrol stations and also perhaps as many more distributors and contract customers for derv.

193. It is assumed that the duty would be set by both tiers of authority. It could in theory be collected by both tiers, but it would be more efficient for only one authority to act as collector. If this task could be combined with other functions (eg weights and measures) it might be undertaken at district level; if not, establishing a collection service at county level should provide economies of scale. If local rates of RFD rose to a high level generally, providing a big incentive to evasion, it might eventually become desirable for Customs and Excise to collect part of the local duty at an earlier stage, acting as agents for the taxing authority, in order to minimise loss of revenue. RFD could well cost in the range of £10m to £15m a year to administer.

Yields and RPI

194. Petrol duty at about 74p per gallon, plus duty on derv at about 63p per gallon, is expected to raise nearly £5½bn in 1983/84. A local road fuel duty averaging 30p to 40p a gallon (ie 34½p to 46p on the VAT inclusive pump prices) would yield about £2½bn to £3bn to local authorities, with a loss to Exchequer of about £½bn; and produce a rise of, say, 20% to 25% on a £1.70 per gallon pump price.

195. RFD might produce sufficient revenue to stand as the sole supplementary tax into the 1990s. If it were introduced in 1986/87, then by 1993/94 average rates of local duty could be (at 1983/84 price levels - on a specific basis see Annex K paragraph 16) about 40p per gallon; this would be in addition to the national rate, which is at present 74p per gallon. In the later 1990s the local rates of duty could easily be equal to the present national duty per gallon (all in 1983/84 terms) (see Annex G, Case III). The RPI effects would be similar in kind to those noted for LST in paragraph 174.

196. The variations in the local levels of RFD are hard to predict. There would be limits to the differences in pump price that could be supported by neighbouring authorities, especially if the tax were variable by district area.

Fiscal implications

197. RFD would have a much smaller impact on the national Exchequer than VED (see paragraph 213), perhaps under £½bn in 1983/84 terms. The national RFD would

be maintained, but the Chancellor's ability to raise additional revenue from this tax would be reduced by the superimposed local RFD.

Gainers and Losers

198. The gainers and losers under RFD are discussed jointly with VED at paragraphs 223-228 below.

Timetable

199. Provided that legislation was introduced in 1984/85 and enacted by the summer of 1985, RFD could be introduced on its own as a supplementary tax in April 1986 (see paragraph 229).

Manpower

200. Perhaps 500-1000 local authority staff might be required to collect, administer and enforce a supplementary RFD, assuming collection by county authorities. Numbers would depend upon the frequency of visits required to retail outlets necessary to minimise evasion, and cannot be estimated precisely. The total administration costs might be in the range £10m to £15m at 1982/83 prices (Annex K, paragraph 14).

Compliance costs

201. The total costs for some 50,000 road fuel outlets cannot be estimated. Each establishment would need to keep detailed records and separate duty returns, in addition to those already required for VAT.

Enforcement

202. Enforcement would be the responsibility of the taxing authorities but should, for reasons of economy, be exercised by one tier only. Economies of scale should be achieved if the responsibility were placed at county level.

Cross-border shopping

203. Motorists already 'shop around' for cheap petrol. If rates of local duty diverged noticeably, retailers in high tax areas could be expected to lose

substantial business, especially where rates to differ from district to district, and particularly in and around metropolitan areas and along motorways. If divergence persisted, large business users would have an incentive to set up their fleet fuelling depots in low tax areas.

Perceptibility

204. The perceptibility of a supplementary RFD would depend very much on the range of divergence in local rates of duty. This in turn would depend on the extent to which authorities tried to harmonise their rates of duty in order to minimise cross-border shopping. Since road fuel prices are set as single figures inclusive of VAT and RFD it might be possible to take special measures to promote perceptibility, for example by requiring local rates of duty for each tier of authority to be prominently displayed in filling stations. The rates of duty could also be notified to property ratepayers with the annual rate demand, but many taxpayers will of course live outside the area of the authority levying the duty.

Frequency of changes in tax rates

205. For ease of administration, the Group consider that local authorities should not be able to vary their RFD rate more than once a year.

"Steps" in tax rates

206. Unlike LST, changes in the rate of duty can be very small (set in terms of 0.1 per litre), avoiding problems of "lumpiness".

Points for Consultation

207. The Group have reached the following provisional conclusions about a local RFD scheme, based on paragraphs 192 to 204 and Annex K, which might be included in any consultation document:

- (a) the duty should be charged on all petrol and derv (as with the national duty, with the same exemptions);
- (b) the possible extension of stage bus fuel grant to cover local RFD on local bus services should be considered;

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- (c) RFD should be charged on a specific basis of price per litre (not ad valorem);
- (d) the tax point would be at the retail stage;
- (e) collection and enforcement would be by one of the taxing local authorities, probably the county tier (except in metropolitan areas);
- (f) where the tax exceeds a given minimum, Customs and Excise might, to minimise evasion, collect part of the duty at national duty points and distribute the revenue to local authorities on a formula basis related to local RFD yield;
- (g) RFD rates should change no more than once a year;
- (h) traders would be required to make returns quarterly for each retail station.
- (i) for reasons of perceptibility, traders might be required to display RFD rates and local authorities might be required to send an annual notice of RFD rates to be in force in the coming financial year to householders.

Vehicle Excise Duty

General

208. The transfer to local authorities of VED on light vehicles is discussed at Annex L.

Models for a VED

209. Local authorities would levy their own rates of VED annually. But the coverage of the tax and its collection should continue to be reserved to central government and the central register kept by the Driver and Vehicle Licensing Centre (DVLC) at Swansea retained, since it is used extensively by the police and for safety purposes. The model assumed therefore is for DVLC to continue to collect locally variable VED on behalf of authorities. The present arrangements

for the issue of licences would be kept broadly unchanged; the payments would go first to the DVLC, which would reallocate them to the appropriate local authority on the basis of the local tax rates and the place of registration of the vehicle.

210. Each tier of local authority could set its own tax rate. DVLC would aggregate the upper and lower tier rates of VED for the purpose of issuing bills to registered keepers of vehicles assigned to district areas on the basis of their postal address.

211. Many motorists mistakenly perceive payment of VED as equivalent to the old Road Fund Licence, and think it ought to be spent on roads. If local VED were transferred to non-highway authorities, district councils, the Department of Transport considers that this would lead to particular criticism by motorists of VED. However, the general arguments against a transfer of a local tax to the county-level only still apply (paragraph 164 above), and therefore this report concentrates upon the implications of a two tier tax.

Yield and RPI

212. A VED on cars and light vans of £85 yields about £1½bn. This would have to be transferred entirely to local government; producing, together with the local RFD, revenue of about £4bn by the mid 1990s (see paragraph 152). With local authority expenditure rising at any annual rate up to about 8%, this option could yield sufficient revenue into the mid 1990s. However, this source of revenue is not as buoyant as LST, and if local authority expenditure increased and would not sustain higher rates of growth in local authority expenditure. The RPI effects would be similar in kind to those noted for LST in paragraph 174.

Fiscal Implications

213. The costs to the Exchequer from handing over VED would be about £1½bn to £2bn (at 1983/84 prices) by the 1990's. A corresponding increase in national taxation (eg of about 2p on basic rate income tax or about 2½% on VAT) would be needed to maintain Exchequer revenues at any given level. VED changes would be entirely removed from the Chancellor's control; it would no longer be possible, for example, to review the recent decision to abolish VED and recoup the revenue through increased national RFD.

Gainers and Losers

214. The gainers and losers under VED are discussed jointly with RFD at paragraphs 223-228 below.

Timetable

215. The main computers at DVLC are being replaced between 1983 and 1986. It is essential to avoid changes which would delay this programme in order to safeguard the revenue. The introduction of a computer based local VED would probably take until April 1988 to leave time to develop and test the new systems. It is unlikely that a local VED could be introduced more quickly by setting up a manual system. The fallibility of the previous manual system led to its abandonment in 1965.

Manpower, Compliance and Enforcement

216. The main burden of initiating and operating a local VED would fall on DVLC. An immediate task, which might be sub-contracted, would be to refine the list of addresses of registered keepers, so that they can be assigned to the appropriate district authority. A permanent increase of some 120 staff on the approximately 500 at present running VED, at an annual cost of £800,000, would be required to operate the scheme (ie to implement changes in VED rates). The work would 'peak' sharply over the short period when authorities draw up budgets and set their local tax rates which would result in a requirement at DVLC for 100 temporary staff at an annual cost of £110,000. But authorities might need to do more work on management and more particularly on enforcement, perhaps requiring an additional 1,000 staff, possibly in some cases adding the work to the duties of traffic wardens. There might be some offsetting savings in central government staff. Overall, there could be an addition of some £10m to £20m to the present costs of about £50m (now borne by central government) for collecting and enforcing VED. The bulk of the present cost is for cars and would be transferred to local government, for which the total cost could therefore be in the range £50m to £60m. Compliance costs for taxpayers would be negligible.

Cross-border Registration

217. Businesses would, if there were no control, be able to register all vehicles in their ownership at whichever of their addresses was most advantageous for tax

purposes. It would be necessary to seek to ensure that wherever possible vehicles were registered at their place of use. But in the case of business fleets, for example hire cars, it is probably impossible to prevent such "cross-border shopping". The extent to which such behaviour would encourage the convergence of tax rates is impossible to predict.

Perceptibility

218. A local VED would be highly perceptible to those who paid it; there would be a demand note sent by DVLC to each registered keeper, indicating to which authorities the duty was payable.

Frequency of changes in tax rates

219. To minimise administrative costs and uncertainty for taxpayers, the Group consider that local authorities should not be able to vary the local rate of VED more than once a year.

"Steps" in tax rates

220. For administrative convenience, authorities should change the rate of duty in minimum steps of £1 for cars and vans.

Points for Consultation

221. The Group have reached the following provisional conclusions about a local VED scheme, for inclusion in any consultation document:

- (a) the duty should be levied on all cars, motorcycles and light vans (reserving VED on lorries as a national tax);
- (b) changes in the structure of the tax should be reserved to central government;
- (c) registration should be at the main place of use;
- (d) to enhance the perceptibility of VED, the demand note sent to each registered keeper should show the authorities to which duty was payable;

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- (e) local authorities could change the rate of duty in minimum steps of £1 for cars and vans;
- (f) rates should be changed no more than once a year;
- (g) collection should be by DTp and costs recovered from local authorities;
- (h) local authorities should have some responsibility for enforcement;
- (i) no rebate or additional tax should be given to or required by domestic payers of VED who move between tax areas with differing rates until the next payment becomes dues.

RFD and VED

A tax for each tier

222. Rates of duty for both supplementary RFD and local VED could be set independently by both tiers of authority. Although this improves flexibility, it could cause some confusion to taxpayers, who could then find themselves paying three different taxes, in each case to two different authorities. The Group have therefore considered whether it might be possible to allocate one of the supplementary taxes to each tier, say RFD to the shire counties and to the metropolitan districts (the major spending tiers) and VED to the shire districts and upper tier bodies in the metropolitan areas and London, since RFD has the higher potential yield. Such an arrangement would simplify tax bills and perhaps enhance accountability, but it would lead to unacceptable inflexibility. It would also be more difficult to allocate the two taxes between tiers of authority and other precepting bodies in the metropolitan areas, where the districts have the larger expenditure. On balance, the Group concluded that it was inadvisable to restrict the operation of the tax in such a way.

Gainers and Losers

223. If RFD and VED were introduced simultaneously, to raise the same revenue as a 1% average rate of LST would initially require a small local RFD on top of the transfer of VED. However, the balance between the two taxes could be expected to

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alter over time. The initial yield of VED would be between £1½bn and £2bn at 1983/84 price levels. The additional yield required from RFD would be less than this into the 1990s; and with 5% growth in both local expenditure and grant the division between the yield of the two taxes could be about 45% RFD and 55% VED in 1993/94. At that point local RFD could average 30p per gallon and VED £85, at 1983/84 price levels. On that basis, the introduction of RFD and VED would entail a direct transfer of about £¼ to ½bn in tax burden from the non-domestic ratepayer to the personal sector for each £1½bn raised; the burden on businesses from the new local taxes would be less than from rates, and the new taxes would not be rebated. The overall effect would be to produce more losses than gains for private households.

224. The table below shows the likely distribution of gains and losses, in terms of changes in personal disposable income, for each £1½bn raised (equivalent to the yield of a 1% LST, for comparison with paragraph 174). It assumes that the burden of rates on the non-domestic sector is not at present passed on to final consumers, whereas the burden of RFD and VED on businesses would be (see paragraph 174). It also assumes that the loss of Exchequer revenue would be made good by a corresponding increase in the rate of national VAT. These are therefore the maximum estimates of losses. The effects might be expected to be spread over about 2 to 5 years.

HOUSEHOLD GAINS AND LOSSES FROM RFD PLUS VED RAISING £1½bn

| <u>Changes as % of Disposable Income</u> | <u>% of Households (E&W)</u> | | |
|--|----------------------------------|------------|---------------------------------|
| | <u>RFD</u> | <u>VED</u> | <u>RFD (45%)+ VED (55%)</u> |
| LOSS More than 6% | 0.2 | 0.2 | 0.1 |
| 3% to 6% | 1.2 | 0.6 | 0.7 |
| 1.5% to 3% | 9.2 | 3.5 | 3.1 |
| 1.5% loss to 1.5% gain | 89.4 | 95.4 | 95.5 |
| GAIN 1.5% to 3% | - | 0.2 | 0.5 |
| 3% to 6% | - | 0.1 | 0.1 |
| More than 6% | - | - | - |
| (Average change; p per week) | -48p | -56p | -45p) |

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225. (Differences of under 1% in the columns of this table can be disregarded.) RFD and VED produce different effects because the RFD would be an additional tax on road fuel whereas the transfer of VED to local authorities would require a corresponding increase in national taxation, assumed to be a 2% increase in VAT. For individual taxpayers a VED could be higher or lower than at present depending on the amount by which their local authority had increased its spending. And for some households the effects of RFD and VED may offset one another. Thus the combined RFD/VED figures and the consequential changes in other taxes appear very close to those for VED alone.

226. As with LST, the losses could be greatest for households on SB, whose rates are now paid for them (paragraph 177). Motorists would tend to lose on average 1% or less of their personal disposable income. Non-motorists' losses would be substantially smaller. The number of people paying substantial amounts of RFD/VED cannot be precisely assessed because some of the relevant information is lacking. But the number is probably rather fewer than the 20 million who pay domestic rates.

227. Rural households now tend to pay lower domestic rates than urban ones; and rather more in national VED and RFD because of higher car ownership and greater car use. Present rate poundages reflect local authority spending, and (assuming that an equalising grant continued, see Section I) local VED and RFD levels would also come to reflect spending levels. Local VED and RFD levels would therefore tend to be lower in rural areas than in urban areas. Preliminary analysis suggests that the net effect on rural households of a move to local RFD/VED might be no greater than the effect on urban households.

228. However, this analysis compares only the more rural two-fifths of English and Welsh households with the more urban three-fifths. No estimate has yet been made of the effects in the most remote areas, including of course large parts of Scotland and Wales. There the cost of petrol is substantially higher (differentials of 30p and 48p a gallon have been reported from Orkney and Shetland); and reliance on private vehicles is also high. Taxes on motoring are taxes on a higher proportion of total households expenditure in those areas than elsewhere; and also bear more of the character of taxes on a necessity. Further analysis is in hand to investigate this aspect, and to show any likely shift of tax-burden between regions.

Early introduction of RFD

229. If early introduction of the supplementary tax were considered of overriding importance, it would be possible to bring in RFD alone in April 1986 as a district area tax. But the Group consider that RFD could not serve indefinitely as the whole supplementary tax. The tax base is too narrow and it might be perceived (whether or not correctly) as bearing particularly heavily on motorists in rural areas (including large parts of Scotland and Wales). Moreover, the yield of RFD at district area level may prove hard to predict, making it difficult for local authorities to budget. The Group therefore consider that, even if RFD were introduced on its own, VED should be transferred to local control soon after. The earliest date practicable appears to be 1988.

F. COMPARISON OF THE SUPPLEMENTARY TAX OPTIONS

230. In comparing the two options of LST and RFD/VED, the following points are relevant:

- (a) impact on individuals: LST would be paid by some 40 million adults plus children; VED by some 15 million motorists and motorcyclists and RFD as regards its direct effects by the same group plus other drivers, fewer than 20 million all told. In both options there would be some shift in the tax burden from the non-domestic to the domestic sector. But for most people the impact would be marginal, after taking account of the effects the scheme would have on property rates and national VAT (on the assumptions VAT had to be increased to offset any loss in Exchequer revenue through the new local tax, and to pay for any extra grant which might be required). Since it is paid by more people, LST might be perceived as a fairer tax than RFD/VED, which bears heavily on motorists and might be seen, even if mistakenly, as being particularly unfair to rural motorists. But supplementary benefits would need to be adjusted to take account of the extra net burden of LST on SB recipients if it were not to be regressive;
- (b) impact on business: overall, the non-domestic sector would benefit from the switch to supplementary taxes from property rates. But LST would impose large compliance costs additional to VAT requirements on

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a wide range of businesses including virtually all retailers (perhaps 500,000), and RFD on retail and trade petrol and derv outlets (perhaps up to 50,000 all told). In either case, retailers would be concerned about the threat to turnover represented by the prospect of cross-border shopping arising from differing tax rates in adjacent district areas. The extent to which the threat materialised would depend upon how far tax rates converged in practice. VED does not present similar problems. To ensure that LST would not disadvantage exports, and that imports were charged on a comparable basis, would be administratively complex;

- (c) accountability: LST and RFD are not as "perceptible" as rates to the electors of the authority concerned (VED would be no less visible than rates, but would apply to fewer electors). Steps could be taken, more easily with RFD than LST, to ensure that notices showing the relevant tax rates were displayed at the point of sale;
- (d) tax base: either LST or RFD/VED would give an adequate yield of tax nationally through the 1990s, although the latter is a less buoyant source. But if the taxes were to apply to district areas, yield would be unpredictable and, in the case of LST, possibly 'lumpy'. Authorities would be concerned about whether taxable capacity was adequate at the district level, and about uneven distribution between authorities (eg the irregular distribution of hypermarkets in the case of LST);
- (e) fiscal implications: the Chancellor's discretion to change national rates of duty would be affected in the case of VAT by LST and of national road fuel duty by local RFD. The transfer of part of a national tax, VED on light vehicles, to local control, would have a proportionately greater affect. In the 1990s, the introduction of either option would imply an increase in national taxation of roughly 2p on the basic rate of income tax or 3% on VAT. Neither option would have a marked effect on the RPI;
- (f) EC Implications: only LST is significantly affected by EC requirements. The Law Officers have said that it would be advisable to consult the Commission before taking a firm decision to proceed

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with LST, in order to minimise the risk of a subsequent adverse judgement. (A derogation from the Commission to set LST and VAT at mutually exclusive rates would also be needed if LST were to be set at decimal points rather than whole numbers;)

- (g) structure of local government: either LST or RFD/VED could operate if the GLC and metropolitan county councils were abolished. The Group consider that, in the RFD/VED option, both taxes would need to be made available to both tiers of authority;
- (h) administration: both options raise problems of collection and of enforcement. The numbers of staff required for LST, chiefly in Customs and Excise, are a firmer estimate than for RFD/VED where the main staffing implications are for local government. Numbers may be somewhat greater for LST, but this depends critically on the extent of the enforcement effort required for RFD/VED. The overall gross costs of the alternative schemes are broadly comparable (LST in the range of £40m to £60m as against RFD/VED in the range £60m to £75m). The net costs of RFD/VED are rather lower (£20m to £30m) if the existing costs of running VED on cars etc centrally are taken out of the comparison.
- (i) timing: LST, and RFD/VED as a package, could not readily be introduced before April 1988. RFD/VED could be staged, with RFD introduced by April 1986.
- (j) Scotland: Comparable estimates of the gains and losses to households in Scotland for the proposed supplementary taxes have not been made. Preliminary calculations, however, suggest that higher rates of LST and more particularly RFD and VED would be necessary to substitute for a given rate yield in Scotland than in England and Wales and that there could be a greater relative shift in the burden of local taxation from businesses to households. Rural residents in Scotland (27% of the population as opposed to 10% in GB as a whole are likely to see themselves as being particularly affected therefore by RFD and VED, especially since RFD will add to the price of petrol which is already significantly higher than that in urban areas.

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231. The Green Paper "Alternatives to Domestic Rates" canvassed LST as one of the main options. (RFD and VED were mentioned only to be dismissed and elicited few comments.) As an alternative to rates, LST was criticised by representatives of business (large and small), ratepayers associations and all the local authority associations. It was generally unpopular with other respondents, including private individuals (see Annex B to MISC79(82)3). But some of the criticism might not apply with equal force to LST as a supplement to rates rather than a replacement.

G. INTERACTION WITH STRUCTURAL REFORM OF LOCAL GOVERNMENT

232. By retaining the maximum flexibility in the application of supplementary taxes, whatever structural reform of local government may be undertaken should be compatible with the reform of local government finance. Specifically, if the GLC and metropolitan counties were abolished, this should not affect either the option of LST or of RFD/VED, each with locally variable rates.

H. RATES IN THE FINAL SCHEME

233. The Group assume that the ceilings on rate poundages set under the final scheme would be intended to last for at least several years. It would be possible either to set permanent ceilings in the main legislation or to take powers to prescribe them by Order. The latter course would allow greater flexibility. In this case, the ceilings might be subject to further adjustment by means of further Orders.

234. In setting the final ceilings Ministers would no doubt wish to have regard to the permitted levels of rates in the final year of the interim scheme. But the variations between authorities in permitted rate levels under the interim scheme might not be generally accepted as fair and defensible as a basis for a long term reform of local taxation. This would apply especially if rates had been frozen at a base year level (as in Schemes A(i) and B(i)), or if permitted rate increases had been governed by a simple formula which took little or no account of local circumstances. (This would be more likely to happen under Schemes A(ii) and B(ii) than under Scheme C - see paragraphs 33 and 35).

235. It would therefore probably be necessary to provide for individual local authorities to make representations about the rate ceilings to be set for them, under the final scheme.

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236. The Group have assumed that each authority would be free to reduce its rates below the ceiling figure. It would alternatively be possible to provide that once a rate had been reduced, it could not rise again; this might be thought appropriate if the objective were to move as quickly as possible towards the permanent abolition of rates. On the other hand such a provision could act as a disincentive for authorities to reduce rates, since they would thus be permanently reducing their local room for manoeuvre. Moreover the yield of the supplementary tax or taxes is likely to be more unpredictable than that of rates, and possibly more "lumpy" (if it is thought difficult to vary the rate of tax in very small steps). Authorities may therefore need to err on the high side in setting the rate of supplementary tax, and may find that it produces more revenue in the year than they require.

237. This points towards allowing rates, which have a relatively predictable yield, to be used as a regulator to even out year to year fluctuations in local tax yields. On this basis each authority's rate poundage would be allowed to move up or down each year, provided that it remained at or below the relevant ceiling poundage.

238. This arrangement would have the advantage of reducing the extent to which authorities inadvertently acquired surplus tax revenue which could be used to finance extra expenditure. Changes in rate levels could however become even more unpredictable than at present; changes in either direction below the ceiling could be substantial.

I. EQUITY BETWEEN LOCAL TAXPAYERS AND IMPLICATIONS FOR EXCHEQUER GRANTS

239. The introduction of a supplementary tax would make it necessary for Ministers to consider how far, and by what means, to ensure that ratepayers and taxpayers in different authorities paid the same rate of tax for the same level of local services. This raises complex technical problems; but the issues are fundamentally political, in that they concern the incidence of the new system of local taxation on different groups of local taxpayers.

240. The present block grant system compensates individual authorities for differences both in their needs and in their rateable resources. (The basic principle of "equalisation" of needs and resources is explained in paragraphs 12-13 above.)

241. There would be no new problems in continuing the equalisation of differences in needs under a system of multiple local taxes. The existing GRE system could continue unchanged.

242. But equalisation of differences in resources would inevitably be more complex, since it would have to take account of differences both in rateable value and in the tax base of the supplementary tax or taxes. The existence of a rates ceiling, which is a basic feature of the final scheme, would also make for complexity. For ease of exposition it is assumed in the rest of this section a) that LST is adapted as a single supplementary tax, and b) that it is levied as a "district level tax" as defined in section C above. The same principles would apply, mutatis mutandis, to a system with RFD plus VED and to a system with a "county level tax" see (Section D), although the practical difficulties would increase with multiple taxes.

(i) Equity between local taxpayers

243. Questions of equity between different groups of local taxpayers would arise even if the ratio of the two tax bases (rateable value and retail sales) were the same in each authority's area. For if Authority A decided to raise a higher proportion of its revenue from rates, and a lower proportion from retail sales, as compared with Authority B, it could be argued that the ratepayers in Authority A and the shoppers in Authority B were being unfairly disadvantaged.

244. But in practice the ratio of the two tax bases is likely to vary widely between authorities. On the one hand are authorities with high rateable value per head but low retail sales; on the other are authorities with low rateable value but high retail sales (due, for example, to the presence of a regional shopping centre). The former would tend to minimize their aggregate local tax rate by loading more of the tax burden on to the tax base - rateable value - in which they were relatively wealthy; the latter would tend to tax retail sales more heavily. This would produce disparities in both rate poundages and rates of LST which it would be difficult to defend. Since many of those who shop in an area are not resident there, it would be difficult to argue that it made no difference to local taxpayers whether they paid more in rates or in LST.

245. There are two possible ways to solve these problems of equity: one direct, the other indirect, by means of the grant system. Both raise major policy issues.

a) The direct approach: a fixed ratio between the two taxes

246. Under the direct approach the government would impose a requirement that the two tax rates should be maintained in some given relationship to each other in those authorities which levy a supplementary tax. For example, for every 25p of property rate levied by an authority it might be obliged to levy 1% of LST. (This particular ratio would be equal to the present national average, since in 1982-83 a 25p property rate and a 1% rate of LST would both yield about £1750m). The use of this ratio would mean that authorities would have a rate poundage below their ceiling. If it were desired to reduce the relative burden of rates over time, a different proportion between the two rates of tax could be prescribed each year, with the supplementary tax rate increasing progressively relative to that of property rates.

247. If all authorities were thus constrained to maintain the same balance of local taxation between ratepayers and shoppers, the distortions referred to above could be avoided. Block grant could then be paid on much the same basis as at present, compensating for differences in the total taxable resources of each authority, ie rateable value plus retail sales. However, there are three possible objections to a centrally prescribed ratio between the two tax rates.

248. First, it would involve limiting the freedom of individual authorities to determine their own mix of local taxes. It might however be possible to allow some limited local discretion in this.

249. Second, it would not be possible for central government to prescribe a uniform ratio, nor for local authorities to observe it, unless the rate of LST could be varied in steps of less than 1%. This is because the yield of LST is much more "lumpy" than that of rates; that is, a change of 1% in the rate of the tax produces a very large change in the national yield - £1750m, compared with £100m for a 1% change in rate poundage. A fixed ratio between the two taxes could thus only be prescribed if LST were variable in much smaller steps than 1%. If it were variable in steps of 0.1%, each change would vary the yield by £175m at national level. In applying the national ratio to their rate poundage, authorities would have to round the rate of LST to the nearest 0.1%, and the yield of the two taxes would differ from the national ratio is so far as rounding took place. But the system could probably operate with this degree of roughness. (The problem would be smaller in the case of RFD plus VED, since their combined yield would be less "lumpy".)

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250. The third problem arises from the proposition that there should be a rates ceiling as a basic component of the final scheme. If the ratio of the two taxes were fixed nationally, the limit on an authority's rate poundage would impose a limit on its rate of LST. This would be consistent with a general system of control of local authority expenditure or taxation (on which see section J below); but not with a system in which each authority was free to determine the total size of its local tax levy.

251. If there were no overall control of expenditure and taxation, any general rule prescribing the ratio between the two local tax rates would have to be subject to exception when an authority reached its rates ceiling. Above that level, grant could be paid so as to equalize for differences in the yield of the supplementary tax. This would make the system more complicated, but not unworkable.

252. A nationally prescribed ratio between rates and LST may not be considered acceptable. In that case an indirect approach, via the grant system, would be needed.

b) The indirect approach: retrospective adjustment through the grant system

253. Under this approach there would be no fixed ratio between the two taxes, and authorities would remain free to determine their own mix of local taxation, subject to the limits on rate poundages. Grant would initially be calculated as if authorities levied the assumed national mix. It would be adjusted retrospectively to take account of the actual local mix, to remove any financial advantage an authority may have derived by loading the tax onto that source in which it was relatively wealthy. In this way, the financial incentive for authorities to exploit one group of local taxpayers would be reduced. In so far as authorities exercised their freedom to vary the local tax mix, equity between ratepayers and shoppers or motorists in different areas would be achieved. An arrangement of this kind would be complicated, and would require large scale - though predictable - adjustments of grant entitlements in respect of prior years.

254. For any system of resource equalisation it is necessary to define the tax base for each authority which has power to raise revenue. In the case of LST levied as a "district area tax" it would be necessary to collect data of retail sales by district area. This would have to be done during the interim period, so

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that an adequate data base was available for establishing an equitable grant distribution in the first year of the final scheme. (The same requirement would apply to RFD plus VED).

255. It would be much more difficult to predict the yield of LST than of rates, since the size of the tax base - retail sales - would be likely to vary from year to year both nationally and between individual authorities. It would be necessary to decide how far Exchequer grant should be paid to authorities to make up any shortfall on the yields predicted at the time of the annual grant settlement. (A similar issue would arise in relation to RFD plus VED.)

256. Resource equalisation under a two-tax system thus requires either a) a centrally determined ratio between the two tax rates or b) a complex system of retrospective grant adjustment. If neither of these is acceptable, it would be possible to consider options providing a more limited degree of equalisation.

(ii) Alternatives to full equalisation

257. One option would be to retain the present arrangements for equalising needs and rateable resources between areas, while making no arrangements for equalising in respect of LST or RFD/VED. This would mean that authorities providing a standard level of service would be able to levy the same rate poundage, but would need to levy different supplementary tax rates to meet an assumed local contribution from this source. The effect would be to benefit taxpayers in those areas with a high level of retail sales at the expense of those in areas with a low level of sales. In practice authorities would try to minimise their combined tax rates by loading more of the tax burden on to that base in which they were relatively well endowed.

258. Alternatively, resource equalisation might be abandoned completely. This would involve reversion to a separate needs equalising grant, like the pre-1981/82 Needs element; in current terms only some £2600m in England (30% of the existing block grant) would be required for this purpose. The remaining grant (of £6000m) would then be distributed on a non equalising basis, perhaps in proportion to population or reasonable budgets. However, abandonment of equalisation for differences in rateable value between authorities would produce some large changes to the existing pattern of rates between areas, with large increases in low resource areas like Cumbria, Durham and Lancashire and big

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reductions in London. It would make the maintenance of a rate ceiling in these circumstances very difficult. More generally, the abandonment of resource equalisation would widen disparities in both tax rates and levels of service provision between areas; authorities with low rateable income and low retail sales might find it difficult to fulfil their statutory duties. In the longer term, this form of grant system would encourage out-migration of businesses and population from highly taxed areas; it would tend to accelerate the decline of many inner city and sparse rural areas, which currently benefit from resource equalisation.

259. If resource equalisation were abandoned, it would no longer be possible through the grant system to put equal pressure on marginal spending for high and low resource authorities. Instead, authorities with high rateable value and/or retail sales would be able to increase their spending for a smaller increase in local tax rates than authorities with low rateable resources and/or sales. Consequently, the former would find it easier to disregard spending guidelines.

(iii) Conclusion

260. The only way to secure full equalisation of resources - ie equity between both ratepayers and shoppers (or motorists) in different local authority areas - would be by means of a nationally prescribed relationship between the local tax rates, with special arrangements to deal with the existence of frozen rate poundages. Ministers will need to take an early decision on whether this approach is acceptable, since it would be a major feature of the final scheme.

261. If it is not acceptable, the next best way of promoting equalisation would be by means of a retrospective adjustment of grant to claw back any advantage that an authority sought to obtain by loading the local tax on to the tax base in which it was most wealthy. But in so far as an authority still chose to tax ratepayers and shoppers differentially, equalisation would not be achieved.

262. Other options include

(a) equalisation of needs plus resource equalisation in respect of property rates only;

(b) equalisation of needs only.

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If Ministers do not favour either of the approaches summarized in paragraphs 260 and 261, but wish to retain a measure of equalisation, these options would need to be further developed.

J. CENTRAL CONTROL OF EXPENDITURE

263. At E(LF) on 14 March it was suggested that the final scheme might include direct central control of expenditure by individual authorities. The Group have assumed that this would be implemented by means of a power for the Secretary of State to set limits on the rates of supplementary tax, alongside the rates ceiling.

264. There would be two possibilities: either a general system of control, applying to all authorities, or a system designed to prevent exceptionally high rates of tax and exceptionally high levels of spending.

265. A general system of control would be similar in concept to the interim scheme described in section III. Rules would have to be devised for putting an absolute upper limit on the rate of the supplementary tax or taxes, or for limiting periodic increases in them. If the rates of the local taxes were required to be levied in a prescribed ratio, in order to secure equity between groups of taxpayers in different authorities (see section I above), the property rates poundage and the prescribed ratio would together determine the limit on the rate of the supplementary tax. In either case, as under the interim scheme, Ministers in setting the limits on the tax rates would be making judgements - explicitly or implicitly - about "reasonable budget" levels for individual authorities. It would thus be necessary to provide for a system of derogations, and the same problems of enforcement, legal challenge, and administrative cost would arise. With a permanent scheme of control a detailed body of precedent would build up, and the apparatus of central intervention would become established. Local independence and accountability would tend to disappear.

266. It would be possible to operate a permanent system of general control without any supplementary tax. If a fixed ceiling were set on property rates (ie with no fluctuations upwards or downwards below it), then expenditure could be controlled through the supply of Exchequer grant on the same basis as in interim schemes A or B. This would be a simpler approach than that of controlling the rate of a supplementary tax.

267. A scheme to control only exceptional cases might be based on the outline scheme discussed as Option B in the earlier report by officials annexed to MISC79(82)16. Individual authorities, selected on the basis of past spending and/or rating decisions, would be required to submit their budget proposals for detailed scrutiny, and the Secretary of State would have power, after examining the proposals, to prescribe a maximum rate of supplementary tax. (If the ratio of the two tax rates were fixed, the authorities selected for scrutiny might be already up against their rate ceiling and thus able to levy a higher rate of supplementary tax under the provision for exceptions referred to in paragraph 251. But this would not necessarily be so). Problems of enforcement, legal challenge, and administrative cost would still arise, but not to the same extent as under a general system of control. With a scheme of this kind it would be possible to maintain something more like the present balance between central and local responsibilities. Local accountability would be preserved, because substantial differences in local tax rates would still be possible. The effects on public expenditure are difficult to predict; authorities might tend to increase local taxes and/or expenditure as a precaution in case they were selected for scrutiny and control.

268. Further work on options for control under the final scheme will be needed in the light of Ministers' decisions on a) any system of control under the interim scheme, and b) the long term strategy for local taxation.

K. GENERAL CONCLUSIONS

269. The Group have assumed that Ministers will wish to take and announce an early decision in principle on the shape of the final scheme. The announcement would provide the basis for public consultation, especially with representatives of business and local government, before the details are settled.

Supplementary Taxes: County or District Area?

270. There are three options:

- (i) each county and district to be able to levy its own rate of supplementary tax (the rate paid by the taxpayer would then be a composite);

- (ii) a single rate of tax to be levied in each county area, following consultations between all the taxing authorities within it;
- (iii) the new supplementary tax to be available only to the main spending tier in each area (the counties in the shire areas and the metropolitan districts and London Boroughs)

271. The Group consider that the first option comes closest to the objective of providing an effective supplement to the present rating system which can progressively provide a greater share of the local revenue (paragraph 166). Its biggest disadvantage would be the uncertain yield to individual authorities and the threat, real and perceived, to businesses due to cross-border shopping. The second option would require that the tax rate be set throughout the county at the highest of the levels needed by individual districts. It might lead to unnecessary expenditure and a difficult process of consultation between disparate authorities. The third option is unsatisfactory because rates would need to continue to increase for that tier to which the supplementary tax was not available.

Which supplementary tax?

272. The Group considered three options for a supplementary tax or taxes, all of which could be levied at rates independently variable by both tiers of authority: (paragraphs 150 and 151).

- i. local sales tax; the Group conclude that this should be additional to, but levied on the same range of goods and services as, national VAT and apply not only to domestic but to certain business purchases (excluding goods for resale etc). It should be collected nationally by Customs and Excise acting as agent for the local authorities (see points for consultation in paragraph 190);
- ii. local road fuel duty, collected by one of the taxing authorities concerned, preferably, in the Group's view, the county. It should, the Group conclude, run either (a) from the outset, or (b) after an interval, in combination with the transfer of local control of Vehicle Excise Duty (VED) on light vehicles, collected by DVLC as agents for local authorities (see points for consultation in paragraphs 207 and 221);

iii. RFD in combination with local supplementary duties on alcohol and tobacco. The Group consider that this option is not worth pursuing further the cost of control and compliance in relation to an estimated 400,000 retail outlets would be disproportionately high and because of the further complications of an equalising grant (paragraph 151).

273. Either LST or RFD/VED would yield sufficient revenue to serve as supplementary taxes through the 1990s; RFD/VED would not be as buoyant (paragraph 212).

274. On timing LST and RFD/VED could be available in 1988 (paragraphs 180, 215 and 229); RFD could be introduced alone before VED in 1986 (paragraphs 199 and 229).

275. The two options are compared at paragraph 223; Points which the Group consider should be discussed in public consultation are set out for LST in paragraph 190 and for RFD/VED at paragraphs 207 and 221.

Rate ceilings in the final scheme

276. The Group consider that the final rate ceilings should take account of the levels reached in the final year of the interim scheme. It would probably be necessary to provide for individual authorities to make representations about their final ceilings. The Group also consider that authorities should be free to reduce or increase rates, as long as they were below the ceiling. This would allow rates to act as a regulator to even out year to year fluctuations in local tax yields (see paragraph 237).

Equity between local taxpayers and implications for Exchequer grants

277. The Group conclude that the only way to secure full equalisation of resources ie equity between ratepayers and shoppers in different local authority areas, would be by means of a nationally prescribed relationship between the local tax rates, with special arrangements to deal with the existence of limits of rate poundage. One effect would be that authorities levying a supplementary tax would have property rates below their ceiling. An early decision would be needed on this point (see paragraph 260).

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278. The next best way of promoting equalisation would be by means of a retrospective adjustment to clawback any advantage that an authority sought to obtain by loading the local tax onto the tax base in which it was most wealthy (see paragraph 261). There are options short of full equalisation which could be developed further if neither of these approaches is acceptable (see paragraph 262).

Central control of expenditure

279. A general system of control would be similar in concept to the interim scheme described in Section III.
(see paragraphs 265-266).

280. A scheme to control exceptional expenditure cases only might be based on the outline scheme in the earlier report by officials annexed to MISC79(82)16. Individual authorities would be selected on the basis of past spending and/or rating decisions, and their budgets scrutinised before rates were set (see paragraph 267).

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REFORM OF THE EXISTING RATING SYSTEM

281. Ministers may wish to be reminded of the reforms to the existing rating system recommended by the MISC79 Group, and to consider whether any need to be pursued further. They were:

- (i) Discounts for households consisting of one adult without children (to relate rate payments for domestic ratepayers more closely to the consumption of local services (legislation needed))
- (ii) Separate billing of ratepayers by the different tiers and separate notification of council tenants (legislation needed)
- (iii) Statutory obligation on local authorities to consult local representatives of industry and commerce (legislation needed)
- (iv) Revaluation of the non-domestic sector (earliest date April 1987; no legislation needed. MISC79 rejected a revaluation of the domestic sector)
- (v) Changes to the administration of the rating system designed to achieve staff savings in the Valuation Office (recommendations from a Rayner Scrutiny report; consultation and primary legislation needed)

If Ministers wished to implement any of these reforms and took an early decision to do so it would be possible to legislate, where necessary, in the 1983/84 session.

282. A consequential issue concerns the future of water charges, based on rateable values. If rateable values are not reassessed, then any unfairness as between individual ratepayers will apply also to the incidence of water charges. But the general policy is to move towards metering which, where used, severs the link with rateable values.

Scotland

283. The reforms to the existing rating system which were recommended by the MISC79 Group for Scotland are fewer because a number of those recommended for England and Wales have already been carried out.

284. The reforms recommended were:

- (i) Discounts for single person households (legislation needed)
- (ii) Statutory obligation on local authorities to consult local representatives of industry and commerce (legislation needed)

Separate billing of ratepayers by the different tiers and separate notification of council tenants is already done in Scotland. A full revaluation is to be carried out in 1985. No staff savings equivalent to those following on the Rayner Scrutiny of the Valuation Office can be made since valuation is carried out differently in Scotland (by independent local assessors).

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ANNEX A

MEMBERSHIP OF THE INTERDEPARTMENTAL GROUP
ON LOCAL TAXATION

Department of the Environment (Chairman)
Department of Education and Science
Central Policy Review Staff
Law Officers' Department
Department of Transport
HM Customs and Excise
Scottish Office
Welsh Office
HM Treasury
Home Office

Also received papers:

Lord Advocate's Department (some)
Department of Industry
Cabinet Office

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LOCAL GOVERNMENT STRUCTURE, FUNCTIONS AND FINANCE
BACKGROUND AND PRESENT ARRANGEMENTS

(i) England and Wales

1. Local government in England and Wales is organised in two main tiers. Outside the metropolitan areas the upper tier consists of 46 shire county councils, and the lower tier of 333 shire districts. There are six metropolitan counties in England, with 36 metropolitan districts at the second tier. In London the arrangements are similar to those in the metropolitan areas, with the GLC as the upper tier authority and 33 London boroughs forming the second tier.
2. In addition, a small number of special purpose authorities (eg 3 park authorities) issue precepts for finance to the upper tier authorities, and a very large number of "lower level" bodies (nearly 11,000 parish, town and community councils and 260 internal drainage boards) have powers to issue precepts to the district and borough councils. In London the Inner London Education Authority and the Metropolitan Police Receiver (not a local authority but financed as such) issue precepts to the London Boroughs and a few adjacent shire districts.
3. In all areas, the "second tier" main authorities are the rating authorities. The rates they collect are used to finance their own spending on revenue account, (net of income from grants, charges and other sources), and to pay the mandatory precepts (ie cash demands) received from the upper tier, the special purpose authorities and the "lower level" bodies requiring finance in their areas.
4. Since the Local Government Finance Act 1982, local authorities in England and Wales have not been able to levy a supplementary rate. This brings them into line with the position in Scotland.

Functions

5. The table in Appendix 1 to this Annex shows the main services by class of authority and the estimated distribution of revenue expenditure in 1982/83. The tables in Annexes D(i) and D(ii) show summary national income and expenditure accounts for England and Wales (1981/82 - the 1982/83 figures are not yet available).

6. Local government functions in England and Wales have been substantially changed since 1945. The public utilities run by some of the larger urban authorities have been transferred to the nationalised industries: electricity (1947), gas (1948), and water (1974). Major health functions, including hospitals in some areas, were transferred to the NHS in 1948, and the 9 colleges of advanced technology were transferred from the local authority sector in 1961. Passenger transport in the metropolitan areas outside London went to the PTEs in 1968.

7. In the same period, local authorities' responsibilities have been increased, for example in the areas of personal social services, land use planning and development control, building control, public sector housing, the national parks, conservation, recreation and leisure. Although on balance local government has lost more responsibilities than it has gained, the emphasis has shifted from utilities towards manpower-intensive "personal" services to the public.

8. Local government services form a spectrum. At one end are services essentially national in character, where the Government and the public expect a reasonable minimum standard and some uniformity of provision. These include school education, police, and fire. At the other end are local services, the provision of which is more at the discretion of local authorities. These include leisure and recreation facilities, parks and open space. The former are more likely to be the subject of specific statutory duties and various forms of central government guidance, and some of them are supported by specific Exchequer grants.

(ii) Scotland

9. Local government in Scotland is organised in two main tiers; 9 regional councils whose services include education, police and social work and 53 district councils whose services include housing, leisure and recreation and cleansing. In addition there are 3 islands area councils providing the full range of local services. Each authority levies a rate.

10. In addition joint boards administer the police and fire services in the Highlands and Islands and Lothian and Borders. The costs of each board (after specific grant) are shared by the constituent authorities in proportion to population.

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11. The rating authorities are the regional and islands councils. The rates collected by the islands councils are used to finance their own spending on the revenue account (net of income from grants, charges and other sources). Regional councils collect rates in respect of their own spending and that of all the district councils in the region.

12. The table in Appendix 2 to this Annex shows the main services by class of authority and estimated distribution of expenditure in 1982-83. The table in Annex D(iii) shows in broad terms the financing of gross expenditure in 1982-83.

13. In Scotland also local government functions have been substantially changed since 1945 although not in exactly the same ways as in England and Wales. The main differences are that in Scotland water remains a local authority function. Certain advanced further education colleges and colleges of education are centrally financed in Scotland and there are different arrangements for students awards. In Scotland probation is a local authority service provided by social work departments. There is only one PTE (Strathclyde). In Scotland as in England and Wales local authority responsibilities have been increased in other areas, such as the personal social services.

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ANNEX B - APPENDIX 1

MAIN SERVICES BY CLASS OF AUTHORITIES AND ESTIMATED DISTRIBUTION OF RATE FUND
GROSS REVENUE EXPENDITURE (INCLUDING RF CONTRIBUTION TO HRA) 1981/82

ENGLAND AND WALES - PERCENTAGES

| Service | Shire Counties | Shire Districts | Met Counties | Met Districts | GLC | Boroughs | ILEA/Met Police |
|--|-------------------|--------------------|-----------------|------------------|------|----------|-------------------------|
| Education, School meals and milk | 61 | - | - | 62 | - | 39 | 100 ILEA |
| Libraries, Museums etc | 2 | 1 | 1 | 2 | 1 | 3 | - |
| Personal Social Services | 10 | 0 | - | 13 | 0 | 19 | - |
| Police | 10 | - | 32 | - | - | 1 | 94) |
| Fire | 3 | - | 9 | - | 16 | - | -)Met)Pol |
| Other Home Office | 1 | 1 | 3 | 1 | 4 | 0 | 6) |
| Local Transport | 9 | 9 | 46 | 1 | 35 | 6 | - |
| Refuse collection/ Disposal | 1 | 13 | 4 | 2 | 8 | 3 | - |
| Recreation etc | 0 | 19 | 0 | 4 | 3 | 5 | - |
| General admin (after recharges) | 1 | 10 | 1 | 2 | 0 | 4 | - |
| Other (other environmental services, consumer protection, employment, etc) | 2 | 35 | 4 | 8 | 13 | 10 | - |
| Housing including HRA support | 0 | 12 | - | 5 | 20 | 10 | - |
| TOTAL | 100% | 100% | 100% | 100% | 100% | 100% | |
| TOTAL (£m) ⁽¹⁾ | 11590 | 2150 | 1440 | 4740 | 620 | 3040 | 860 ILEA 690 Met Pol |

⁽¹⁾ The sum of this row differs from the sum of gross rate fund revenue expenditure in England and Wales given in Annexes D(i) and D(ii) which excludes rate fund contributions to HRA (£430m).

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MAIN SERVICES BY CLASS OF AUTHORITIES AND ESTIMATED DISTRIBUTION OF RATE FUND REVENUE EXPENDITURE (INCLUDING RF CONTRIBUTION TO HRA) 1982-83

SCOTLAND - PERCENTAGES

| <u>Service</u> | <u>Regional Councils</u> | <u>District Councils</u> | <u>Islands Councils</u> |
|--|--------------------------|--------------------------|-------------------------|
| Education, school meals and milk | 51 | - | 39 |
| Libraries and Museums | 1 | 8 | 1 |
| Personal Social Services | 11 | - | 7 |
| Police | 9 | - | 4 |
| Fire | 3 | - | 1 |
| *Other Law and Other Services | - | - | - |
| Road and Transport | 13 | - | 18 |
| Refuse Collection and Disposal | - | 19 | 2 |
| Leisure and Recreation | - | 21 | 2 |
| Other Environmental and Miscellaneous Services | 9 | 20 | 18 |
| Central Administration | 3 | 9 | 5 |
| Rate Fund Contributions to Housing (incl HRA) | - | 23 | 3 |
| <u>TOTAL</u> | 100 | 100 | 100 |
| TOTAL (£m) | 2,578 | 582 | 80 |

Note: Figures are net of income from fees and charges but include loan charges.

* Expenditure (which is largely offset by fire income) does not register to one percentage point.

LOCAL AUTHORITY EXPENDITURE AND MANPOWER (ENGLAND AND WALES)

| | 1974/75 | 1978/79 | 1979/80 | 1980/81 | 1981/82 | 1982/83 (Budgets) | 1983/84 (Estimated) Budgets |
|---|---------------------|---------|---------|---------|---------|----------------------|-----------------------------------|
| <u>Net current expenditure</u> | | | | | | | |
| <u>England</u> | | | | | | | |
| (i) £ million, cash | 6080 | 11042 | 12976 | 15682 | 17459 | 16260 ⁽¹⁾ | 20450 ⁽¹⁾ |
| (ii) volume terms ⁽²⁾ | 94 | 100 | 101.8 | 100.7 | 99.9 | 101.7 ⁽¹⁾ | 101.9 ⁽¹⁾ |
| <u>Wales</u> | | | | | | | |
| (i) £ million, cash | 380 | 708 | 824 | 980 | 1085 | 1163 ⁽¹⁾ | 1230 ⁽¹⁾ |
| (ii) volume terms ⁽²⁾ | 92.0 | 100 | 100.9 | 98.8 | 96.7 | 96.4 ⁽¹⁾ | 97.2 ⁽¹⁾ |
| <u>Manpower</u> | | | | | | | |
| FTEs (000s) - Dec | 2088 ⁽³⁾ | 2088 | 2092 | 2053 | 2012 | 2003 | n/a |
| Index | 100 ⁽³⁾ | 100 | 100.2 | 98.3 | 96.3 | 95.9 | n/a |
| <u>General rate increase %</u> | | | | | | | |
| England | 40 ⁽⁴⁾ | 6 | 13 | 23 | 20 | 13 | (6½) |
| Wales | 50 ⁽⁴⁾ | 7 | 16 | 22 | 14 | 3 | 1 |
| <u>RPI⁽⁵⁾ (% increase over previous year)</u> | 18 | 8 | 16 | 16 | 12 | (7) | (6) |
| <u>Increase in LA costs % over previous year⁽⁶⁾</u> | 30 | 9 | 15 | 22 | 12 | (7) | (6) |
| <u>Domestic rate bills as % of personal disposable income</u> | 2.2 | 2.2 | 2.2 | 2.4 | 2.7 | 2.9 | n/a |

- (1) Before shortfall of perhaps 1% to 2% in both 1982/83 and 1983/84. No allowance made for the ½% reduction in NIS between 1982/83 and 1983/84. Expenditure figures for 1983/84 based on incomplete information.
- (2) Defined here as current expenditure deflated by the costs of local authority inputs ie the series shows the volume of inputs.
- (3) March 1975
- (4) Approximate figures; year of local government reorganisation.
- (5) The table shows changes between financial years. The index of retail prices (RPI) measures the changes in the prices of a "basket of goods and services" purchased by households in the United Kingdom. Local authority domestic rates are included and represent about 3% of the value of the "basket".

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- (6) This shows the changes in the costs of inputs (manpower and other running expenses) to local authority expenditure. In most years, the increases in these costs are within 1% or 2% of the increase in the GDP deflator (which is a measure of the changes in costs throughout the UK economy). In 1979 and 1980, local authority costs increased faster than the GDP deflator mainly because of the effect of the Clegg awards on local authority wages and salaries.

LOCAL AUTHORITY EXPENDITURE AND MANPOWER (SCOTLAND)

| | 1974/75 | 1978/79 | 1979/80 | 1980/81 | 1981/82 | 1982/83 Budgets | 1983/84 Budgets (prov.) |
|---|-------------------|---------|---------|---------|---------|----------------------|-------------------------------|
| <u>Net current expenditure</u> | | | | | | | |
| (i) £ million, cash | 730 | 1,415 | 1,695 | 2,156 | 2,386 | 2,633 ⁽¹⁾ | 2,784 ⁽¹⁾ |
| (ii) volume terms ⁽²⁾ | 90.4 | 100 | 102.8 | 104.5 | 102.9 | 105.1 ⁽¹⁾ | 105.2 ⁽¹⁾ |
| <u>Manpower</u> | | | | | | | |
| FTEs (000s) - Dec | - | 252.1 | 259.4 | 259.1 | 255.9 | 252.0 | - |
| Index | - | 100 | 102.9 | 102.8 | 101.5 | 100 | - |
| <u>General rate increase %</u> | 16 ⁽³⁾ | 4 | 17 | 30 | 35 | 12 | 1.9 |
| <u>RPI⁽⁴⁾ (% increase over previous year)</u> | 18 | 8 | 16 | 16 | 12 | (7) | (6) |
| <u>Increase in local authority costs %</u> ⁽⁵⁾ | - | 12 | 17 | 25 | 12 | 8 | - |

(1) Present estimate of shortfall from budgets for 1982/83 is 1½%, and possibly 1% for 1983/84. No allowance is made for the ½% reduction in NIS between 1982/83 and 1983/84.

(2) Defined here as current expenditure deflated by the costs of local authority inputs ie the series shows the volume of inputs.

(3) Approximate figures.

(4) The table shows changes between financial years. The index of retail prices (RPI) measures the changes in the prices of a "basket of goods and services" purchased by households in the United Kingdom. Local authority domestic rates are included and represent about 3% of the value of the "basket".

(5) This shows the changes in the costs of inputs (manpower and other running expenses) to local authority expenditure. In most years, the increases in these costs are within 1% or 2% of the increase in the GDP deflator (which is a measure of the changes in costs throughout the UK economy). In 1979 and 1980, local authority costs increased faster than the GDP deflator mainly because of the effect of the Clegg awards on local authority wages and salaries.

LOCAL AUTHORITY GROSS REVENUE EXPENDITURE AND ITS FINANCING - ENGLAND 1981/82
(All revenue accounts)

| <u>Expenditure</u> | <u>£ million</u> | | <u>Income</u> | <u>£ million</u> | |
|--|------------------|-------------------------|--|-------------------|---------|
| | 1981/82 | 1982/83 (Estimates)* | | Rate Fund Account | 1981/82 |
| <u>Rate Fund Account</u> | 10700 | | <u>Rate Fund Account</u> | | |
| Education | | | Rates - domestic | 3910 |) |
| School meals and milk | 640 | | non-domestic | 5170 |) 10400 |
| Museums and Libraries | 360 | | Rate Rebate Grant | 300 | 400 |
| Health and Social Services | 2260 | | Rate Support grants | | |
| Police | 2190 | | - block | 8370 | 8300 |
| Fire | 480 | | - domestic rate relief | 650 | 700 |
| Other Home Office | 290 | | Specific service grants | 2450 | 2700 |
| Public Passenger Transport | 620 | | | | |
| Other Transport | 1570 | | Police | 970 | |
| Housing (Non-HRA) | 460 | | Transport | 210 | |
| Refuse disposal/collection | 630 | | Education | 730 | |
| Recreation etc | 760 | | Housing (non-HRA) | 250 | |
| General Admin (after recharges) | 510 | | Other | 290 | |
| Other | 1820 | | | | |
| All rate fund services | 23290 | 25700 | Sales, Fees and Charges | 2070 | |
| | | | Other income (including interest receipts; excluding recharges) | 1490 | |
| <u>Housing Revenue Account</u> | | | <u>Housing Revenue Account</u> | | |
| Supervision, management, repairs etc | 1790 | | Rents | 2560 | |
| Debt charges | 2820 | | Government subsidies, grants | 1220 | |
| | | | Other income (including interest receipts) | 470 | |
| <u>Trading Services Account</u> | 680 | | <u>Trading Services Account</u> | | |
| <u>Transfers to capital accounts etc and changes in balances</u> | 670 | | Sales, Fees and Charges | 480 | |
| | | | Other income (including interest receipts and Government grants) | 110 | |
| <u>Total Revenue Expenditure</u> | 29250 | 31500 | <u>Total Revenue Income</u> | 29250 | 31,500 |

*from incomplete information

LOCAL AUTHORITY GROSS REVENUE EXPENDITURE AND ITS FINANCING - WALES 1981/82
(All revenue accounts)

| <u>Expenditure</u> | <u>£ million</u> | | <u>Income</u> | <u>£ million</u> | |
|--|------------------|-------------------------|--|-------------------|---------|
| | 1981/82 | 1982/83 (Estimates)* | | Rate Fund Account | 1981/82 |
| <u>Rate Fund Account</u> | | | <u>Rate Fund Account</u> | | |
| Education | 666 | | Rates - domestic | 147 |) |
| School meals and milk | 40 | | non-domestic | 233 |) 408 |
| Museums and Libraries | 16 | | Rate Rebate Grant | 12 | 15 |
| Health and Social Services | 124 | | Rate Support grants | | |
| Police | 108 | | - block | 702 | 780 |
| Fire | 29 | | - domestic rate relief | 48 | 25 |
| Other Home Office | 17 | | Specific service grants | 149 | 146 |
| Public Passenger Transport | 10 | | | | |
| Other Transport | 131 | | Police | 49 | |
| Housing (Non-HRA) | 32 | | Transport | 19 | |
| Refuse disposal/collection | 29 | | Education | 43 | |
| Recreation etc | 56 | | Housing (non-HRA) | 21 | |
| General Admin (after recharges) | 33 | | Other | 17 | |
| Other | 119 | | | | |
| All rate fund services | 1409 | 1530 | Sales, Fees and Charges | 108 | |
| | | | Other income (including interest receipts; excluding recharges) | 82 | |
| <u>Housing Revenue Account</u> | | | <u>Housing Revenue Account</u> | | |
| Supervision, management, repairs etc | 92 | | Rents | 152 | |
| Debt charges | 140 | | Government subsidies, grants | 60 | |
| | | | Other income (including interest receipts) | 9 | |
| <u>Trading Services Account</u> | 43 | | <u>Trading Services Account</u> | | |
| <u>Transfers to capital accounts etc and changes in balances</u> | 47 | | Sales, Fees and Charges | 27 | |
| | | | Other income (including interest receipts and Government grants) | 4 | |
| <u>Total Revenue Expenditure</u> | 1733 | 1840 | <u>Total Revenue Income</u> | | |
| | | | | 1733 | 1840 |

*from incomplete information

LOCAL AUTHORITY GROSS REVENUE EXPENDITURE AND ITS FINANCING - SCOTLAND 1979/80
(All revenue accounts)

| Expenditure Rate Fund Account | £ million | | Income Rate Fund Account | £ million | |
|--|-----------|-------------------------|---|-----------|-------------------------|
| | 1979-80 | 1982/83 (Estimates)* | | 1979/80 | 1982/83 (Estimates)* |
| Education | 911 | | Rates - domestic | 257 | 470 |
| School meals and milk | 65 | | non-domestic | 460 | 930 |
| Museums and Libraries and Galleries | 32 | | Rate Rebate Grant | 25 | 60 |
| Social Work | 196 | | Rate Support grants | | |
| Police | 164 | | - block | 1181 | 1620 |
| Fire | 44 | | - domestic rate relief | 14 | 14 |
| Other Law, Order and Protective Services | 5 | | Specific service grants | 142 | 170 |
| Roads and Transport | 206 | | Police | 75 | |
| Housing (Non-HRA) | 79 | | Transport | 3 | |
| Planning | 50 | | Education | 2 | |
| Leisure and Recreation | 114 | | Housing (non-HRA) | 46 | |
| Central Admin | 114 | | Other | 16 | |
| Other | 57 | | Sales, Fees and Charges | 107 | |
| All rate fund services | 2227 | | Other income (including interest receipts; excluding recharges) | 72 | |
| <u>Housing Revenue Account</u> | | | <u>Housing Revenue Account</u> | | |
| Supervision, management, repairs etc) | 498 | | Rents | 255 | |
| Debt charges) | | | Government subsidies, grants | 201 | |
| Trading Services Account | 131 | | Other income (including interest receipts) | 5 | |
| Transfers to capital accounts etc and changes in balances | -65 | | <u>Trading Services Account</u> | | |
| <u>Total Revenue Expenditure</u> | 2791 | 4250 | Sales, Fees and Charges | 67 | |
| | | | Other income (including interest receipts and Government grants) | 5 | |
| | | | <u>Total Revenue Income</u> | | |
| | | | | 2791 | 4250 |

*from incomplete information

RATE INCREASES IN ENGLAND 1981/82 TO 1982/83

1. The attached histogram shows the spread of rate poundage (percentage) changes between 1981/82 and 1982/83 in English local authorities. The changes include precept changes for the counties (metropolitan and non metropolitan), GLC, ILEA, and the Metropolitan Police, and the local rate changes for districts and boroughs.

2. The figures underlying the histogram indicate that rate changes varied from -40p to +46p or from -44% to over +90%.

3. The central government cash limit factor for the period was about 6% (based on 9% for prices and 4% for pay settlements). In 1982/83, on average, local authorities budgetted for an increase in their current expenditure costs of 8.3% (1981-82 to 1982-83). Actual inflation was about 1 percentage point lower.

4. Most rate changes were concentrated around these levels of inflation. But the histogram shows the large number that exceeded them. The rate increases of 172 authorities (41%) were greater than actual inflation; and the rate increases of 188 authorities exceeded the government's cash limit factor.

5. The range of rate increases reflects a number of pressures on local authorities. These include:

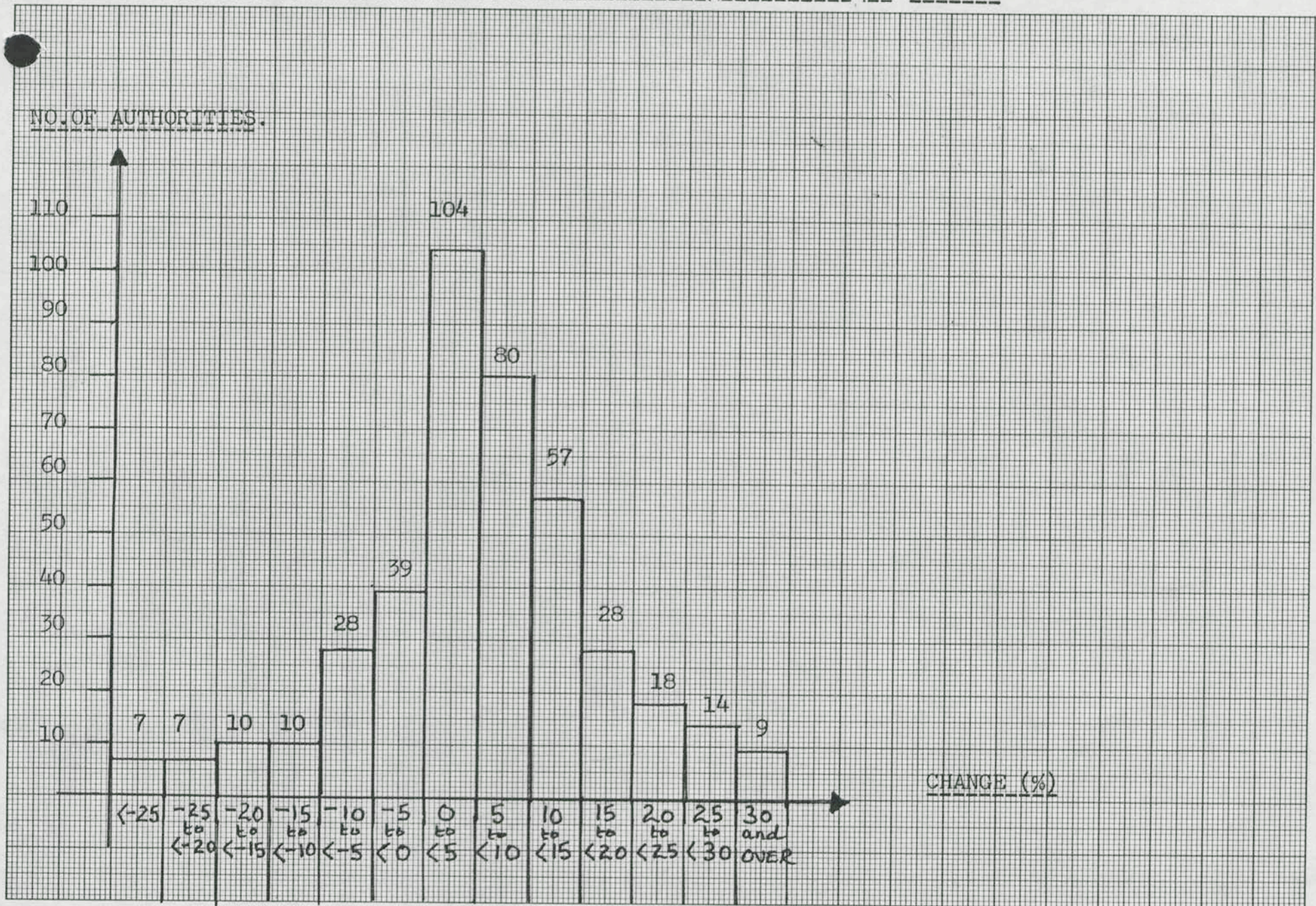
Central Government influences

- (i) changes in aggregate Exchequer support,
- (ii) changes in the distribution of grant,
- (iii) targets and holdback.

Local influences

- (iv) expenditure decisions by local authorities,
- (v) financing decisions by local authorities (eg use of balances),
- (vi) differring impact of the rate of inflation on individual authorities.

% CHANGES IN LOCAL RATE POUNDAGE/PRECEPT FROM 1981/82 TO 1982/83 ENGLAND



RATE INCREASES IN SCOTLAND 1981/82 TO 1982/83

1. The attached histogram shows the spread of rate poundage (percentage) changes between 1981/82 and 1982/83 in Scottish local authorities.
2. The figures underlying the histogram indicate that rate changes varied from -12p to +23p or from -16.7% to +47.5%.
3. The central government cash limit factor for the period was about 6% (based on 9% for prices and 4% for pay settlements). In 1982/83, on average, local authorities budgetted for an increase in their current expenditure costs of 7% (1981/82 to 1982/83). Actual inflation was about 1 percentage point higher.
4. The histogram shows that rate increases are not closely related to the actual rate of inflation. Less than one quarter of authorities had rate changes below the actual rate of inflation. The range of rate increases reflect a number of other pressures on local authorities in Scotland. These include:

Central Government influences

- (i) reductions in aggregate Exchequer support,
- (ii) changes in grant distribution,
- (iii) mid year adjustments to grant in response to high levels of local authority expenditure. These are intended to secure commensurate expenditure reductions, but experience suggests that authorities are rating for the grant shortfall in the ensuing year.

Local influences

- (iv) expenditure decisions by local authorities,
- (v) financing decisions by local authorities (eg use of balances),
- (vi) differing assumptions about the rate of inflation on individual authorities.

Other Influences

- (vii) effect on local rating base and rate income of Court decisions on appeals against revaluation of property at 1 April 1978.

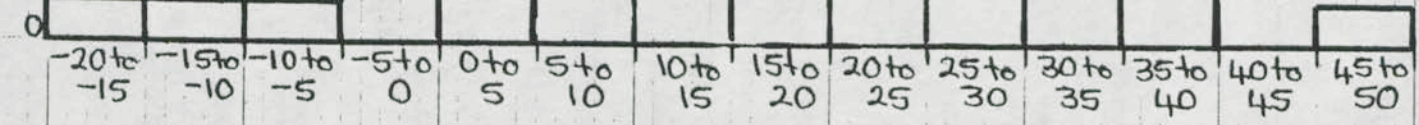
% CHANGES IN LOCAL AUTHORITY RATE POUNDAGE
FROM 1981-82 TO 1982-83 SCOTLAND

No of
Authorities

20
15
10
5
0

-20 to -15 -15 to -10 -10 to -5 -5 to 0 0 to 5 5 to 10 10 to 15 15 to 20 20 to 25 25 to 30 30 to 35 35 to 40 40 to 45 45 to 50

% Change



STATUTORY DUTIES AND POWERS - ENGLAND AND WALES

INTRODUCTION

1. Section III(c), at paragraph 59, sets out some of the issues which the Secretary of State would have to take into account when considering derogations from a formula control on rates. The arguments for special treatment could reflect the various statutory obligations placed on local authorities, and the policy guidance of Ministers and Departments about the provision and standards of services. This Annex lists statements by the main service Departments about the more important duties imposed by statute on Ministers and local authorities in England, their powers, and any other functions which might have implications for the control of local authority rates. In Wales local authorities are in the same position as those in England. The Secretary of State for Wales has duties and powers which mirror those in England of the Secretaries of State for Transport, Education and Science (excluding pay and conditions of service of teachers), Social Services, and the Environment.

NOTE BY THE HOME OFFICE

2. Duties of the Secretary of State

| | |
|---------------------|--|
| Police | general statutory responsibility to promote efficiency in all forces; police authority for Metropolitan police, answerable to Parliament. |
| Magistrates' courts | Ministerial responsibility for the law in respect of the powers and procedures of magistrates' courts. |
| Probation | no direct statutory responsibility for the administration of the probation service, but is answerable in Parliament for the legal framework within which the service operates, for the exercise of his statutory powers (including the administration of the specific grant towards the cost of the service) and for any guidance on policy that he gives. |
| Fire | central responsibility for fire service in England and Wales. |

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Coroners responsible for the law under which coroners work.

Civil Defence responsible for determining the civil defence functions of local authorities and for ensuring that these functions are discharged correctly.

3. Powers of the Secretary of State

Police authorises force establishments; fixes pay and allowances; determines police authorities' contribution for common police services; authorises capital expenditure on land and buildings; may withhold specific grant if force is inefficient; approves Metropolitan Police budget and precept on boroughs and districts in Metropolitan Police District (Inner London for magistrates' courts and probation); determines contributions and benefits under the Police Pensions Scheme;

Magistrates' courts approves determinations of Committee of Magistrates for Inner London, including pay awards; decides on appeals by local authorities against decisions (mainly involving expenditure) taken by magistrates' courts committees; approves payment of specific grant on pay awards to magistrates' courts staff outside Inner London; approves appointments of additional staff and expenditure on computers and other equipment; authorises capital expenditure on land and buildings.

Probation approves pay awards for probation officers; decides on appeals by local authorities against determination of budgets by probation committees; approves numbers of posts of Chief, Deputy Chief, Assistant Chief and Senior Probation Officer; approves appointments of Chief Probation Officer made by probation committees; authorises capital expenditure on land and buildings.

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Fire

approves reductions in numbers of operational firemen, and appliances and closure of fire stations, makes establishment, reinforcement or combination schemes if necessary; makes arrangements for the purchase of equipment if necessary, prescribes by regulations:

- a) discipline code,
- b) qualifications for appointment and promotion of officers and, termination of their appointment,
- c) design or performance of equipment,
- d) standards of training,

appoints Inspectors, holds public enquiries into certain matters, constitutes an Advisory Council, makes and varies a Pension Scheme.

Coroners

considers appeals in respect of coroners' salaries; prescribes jurors' and witnesses fees and allowances, and post-mortem fees.

Electoral registration

makes regulations about the procedure to be followed in the preparation of the register.

Civil Defence

approves payment of specific grant towards authorities' expenditure in performing civil defence functions.

4. Other functions of the Secretary of State

Police

HM Inspectors of Constabulary, his professional advisers, inspect each force annually and advise on ways of improving efficiency; advises police authorities and chief police officers on wide range of policing matters, many of which have expenditure implications.

Magistrates' courts

circulars issued to justices' clerks and clerks to magistrates' courts committees about appointment of additional staff, expenditure on computers, the keeping of accounts and on expenditure which will rank for specific grant.

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- Probation the Probation Inspectorate, his professional advisers, visit each probation area at least annually and report; they also serve as a means of communication with areas about government policy; Departmental circulars and other letters of guidance issued to Chief Probation Officers, Secretaries of Probation Committees and local authority treasurers (as appropriate) explaining changes in legislation and giving guidance about practice of probation officers in exercising their statutory functions and about levels of minor and incidental financial support for probationers and others.
- Fire through regular inspections by Fire Services Inspectorate ensures that local authorities fulfil their statutory duties; in consultation with local authority and fire service interests issues advice on operational and fire prevention matters, equipment and training and minimum fire cover standards, the requirements of which are taken into account in relation to reductions in establishments; establishes and maintains a central training institution.
- Coroners circulars of guidance are issued to coroners which may have expenditure implications.
- Electoral registration the Department's memorandum of guidance advises procedures which add specifically to the cost of producing the register.
- Civil Defence Departmental circulars convey advice and guidance, the implementation of which involves expenditure.

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5. Duties of local authorities

- Police the police authority, a committee of the county council consisting of $\frac{2}{3}$ councillors and $\frac{1}{3}$ magistrates, has a statutory duty to maintain an adequate and efficient police force; for a police authority for a county police area the county council must approve overall expenditure but it is obliged to provide for pay and allowances (about 75% of total); the police authority for a combined police area is a body corporate and precepts upon the constituent councils.
- Magistrates' courts required to provide necessary funds, which are eligible for 80% grant, for magistrates' courts committees, subject to appeal procedure described in 3 above.
- Probation as for magistrates' courts.
- Fire GLC and county councils required to provide a fire brigade to meet efficiently the normal fire fighting requirements of their area (covering training, communications, salvage, collection of information); join in schemes for mutual reinforcement; ensure adequate supply of water for fighting fire; organise brigade for civil defence purposes; inspect premises and impose fire precautions requirement; issue fire certificates in respect of premises designated by the Home Secretary; advise district councils on plans for new buildings and on fire safety in various classes of licensed buildings.
- Coroners County councils are statutorily responsible for the appointment of coroners, for their salaries and office expenses and for reimbursing expenses incurred in the exercise of their duties.

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Electoral registration District and London borough councils appoint an official who is required to prepare and publish an annual register, complying with any general or special directions given to him by the Home Secretary.

Civil Defence GLC and county councils are under statutory duty to make specified plans for civil defence purposes and, on request, to take preparatory steps to ensure that those plans can be carried out; and to carry them out. Other local authorities are required to assist. New statutory duties are in prospect relating to physical provision, training and exercising.

6. **Powers of local authorities** The powers of local authorities in this area are of little importance when compared with the duties that are placed on them.

7. **Implications of control** The law and order services and civil defence are the subject of specific grants because of their national dimension. Under present arrangements local authorities have met their statutory duties, having by and large set their priorities so as to provide adequate levels in these and the other Home Office services, including fire. A rigid ceiling on local authorities' expenditure could change that.

8. The Home Secretary takes specific decisions, for example on police and certain other groups' pay, budgets for magistrates' courts and probation committees when the appeal procedure is invoked, and the Metropolitan police budget and precepts, which translate directly into local authority expenditure, and his decisions on establishments have an almost equally direct effect. Additionally he sets standards of service by qualitative and quantitative advice and where applicable may withhold specific grant if local authorities fail to provide an efficient service.

9. Local authorities seeking derogations would have wide scope for quoting the Home Secretary's decisions or advice in support of their spending plans. The Home Secretary's statutory responsibilities, which are generally part and parcel of the present nature of the services, would not permit him simply to retract in the face of an awkward derogation application and there would be conflict with other Ministers.

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10. Local authority budgets for the Home Office services are not subject to examination by Home Office officials. The scrutiny of budgets and passing judgement on them would require additional staff, who would need to be trained for the work, and would place the Home Secretary in a new relationship with the services for which he is responsible.

NOTE BY THE DEPARTMENT OF TRANSPORT

11. **Duties of the Secretary of State** Those transport functions which need to be carried out on a national basis are the responsibility of central government or the nationalised industries. The Secretary of State has no specific duties in respect of local transport which traditionally has been the responsibility of local government.

12. The Transport Act 1983 provides for the Secretary of State to give initial guidance to transport executives on the level of revenue support on which they should plan and then to give guidance on the maximum appropriate level of subsidy - protected expenditure levels (PELs).

13. **Powers of the Secretary of State** The Secretary of State has no powers of control or default or appellate powers to ensure general or minimum levels of local transport services, although he has an overall responsibility for road safety, reflected in regulatory powers relating to speed limits, traffic signs etc. Like other Ministers, the Secretary of State contributes to capital control by deciding an annual allocation for transport.

14. **Other functions of the Secretary of State** The Department has few formal advisory functions. It exercises considerable influence over technical standards etc, but this is achieved informally, mainly through professional leadership.

15. **Duties of local authorities** Local authorities have a specific duty to maintain highways. Under Section 56 of the Highways Act 1980 any person may apply to the Courts for remedial action and (under Section 58) authorities are liable for any damage resulting from failure to carry out their duties. They also have a general duty to prepare and carry out programmes to promote road safety which may involve lighting, maintenance and traffic control.

16. For public transport the GLC and metropolitan counties have a duty to promote the provision of integrated and efficient services. The interpretation of this duty has been the subject of recent judicial review. The duties of the authorities interlock with those of the transport executives. Under the Transport Act 1983, now before Parliament, they have a duty to break even each year. A reduction in subsidies to the executives resulting from a limitation on rate increases could place the executives in breach of their statutory duty and at the extreme, could leave them unable to meet their commitments. The executives in the metropolitan counties also have a special duty under Section 20 of the Transport Act 1968 to enter into agreements with BR for local rail services, which they might be unable to fulfil. Shire counties have a duty to make plans for public transport in their areas and to enter into agreements with operators, but there is no specific duty to subsidise them.

17. **Powers of local authorities** For highways local authorities have wide powers to carry out construction, improvement, maintenance, lighting, signing etc. The other powers are mostly permissive, but where authorities have provided street lighting, traffic signals etc, if they decided as a matter of policy not to keep them alight they might be liable for any damage which resulted, eg in an accident.

18. For public transport the legislation provides powers for the GLC and metropolitan counties to subsidise public transport services through the medium of the PTEs and London Transport. The shire counties also have powers to subsidise bus and rail services. Both tiers of local authorities have powers to pay transport operators for concessionary fares for the elderly and disabled.

19. **Agency functions of local authorities** The Secretary of State delegates trunk road maintenance responsibilities to local authorities acting as his agents. Agent authorities are reimbursed for this work, but if their staff were greatly reduced they might no longer be able to carry it out. The Secretary of State would then need to transfer the work to the private sector, possibly at much higher cost for some types of work, eg where a lot of stand-by time is involved.

20. **Implications of control** The requirements of local authorities' transport duties are not precisely defined. Authorities which were trying to comply with a limit on rate increases might therefore cut transport spending more sharply in

order to meet more explicit duties. But authorities which wanted to show that a limit was unreasonable would have plenty of scope for claiming that they could not fulfil their responsibilities. The results of the latest national road condition survey show a significant deterioration and some authorities could make out a strong case for increased expenditure to meet their maintenance obligations.

21. On public transport the initial advice to be issued under the Transport Act and the setting of PELs will give the GLC and metropolitan counties ample opportunity to seek derogation or judicial review. Withdrawing from agreements with BR could leave the Secretary of State with a choice between supporting the services through the PSO grant or deciding on an application for closure.

22. Controls could also affect capital expenditure. Several authorities have claimed that the revenue effects of capital spending up to their allocation would push them over their targets for 1983/84. Although it is unlikely that an authority could demonstrate that the allocation and the target were contradictory, the revenue implications of the Government's capital allocations will need to be borne in mind when devising controls. It would be particularly embarrassing for the Department if authorities refused to go ahead with schemes which provided necessary links to the trunk road system or otherwise supported Departmental policies, eg 'Armitage' by-passes.

NOTE BY THE DEPARTMENT OF EDUCATION AND SCIENCE

23. **Duties of the Secretary of State** The Secretary of State has a general duty "to secure the effective execution by local authorities, under his control and direction, of the national policy for providing a varied and comprehensive education service in every area". He has various specific duties regarding the training, employment and remuneration of teachers. He also has a duty to cause inspections to be made of educational establishments. The government has recently introduced the policy of publishing reports by HM Inspectorate; these reports generally include an account of the level of resources observed in the institutions concerned.

24. **Powers of the Secretary of State** The Secretary of State has various powers to assist in discharging his general duties regarding the education service. He

is empowered, if he is satisfied that a local education authority (LEA) has failed to discharge any of its duties under the Education Acts, or has acted unreasonably in exercising any duties or powers, to direct the LEA accordingly. These powers have been used on a small number of occasions only, but they have made it necessary for the Secretary of State to examine in great detail allegations by parents and others in a number of areas that their LEAs were not carrying out their duties. These allegations frequently refer to the level of resources provided by the LEA in particular parts of the service. There would no doubt be many more such complaints, some perhaps justified, if LEAs' spending were directly controlled under a new Act.

25. The Secretary of State has powers regarding certain specific aspects of LEAs' provision. For example, his approval is generally required for proposals to establish or close schools. These proposals, which can generate intense local controversy, frequently have financial implications, notably through the savings LEAs plan to achieve by closing schools. The introduction of tight rating limits might make it more difficult for the Secretary of State to give proper weight to the broader educational considerations raised by such proposals.

26. **Duties of local authorities** LEAs have a duty to secure the provision of primary and secondary schools "sufficient in number, character and equipment to afford for all pupils opportunities for education offering such variety of instruction and training as may be desirable in view of their different ages, abilities and aptitudes and of different periods for which they may be expected to remain at school".

27. LEAs have various duties regarding specific aspects of education in schools, and some of these have direct financial implications, for example, duties

- i. to secure that school premises conform to standards prescribed by the Secretary of State;
- ii. to make arrangements for the provision of such free transport as the authority thinks necessary or the Secretary of State directs;
- iii. to provide a careers service;
- iv. to pay teachers' salaries in accordance with current regulations;

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- v. to provide free school meals for pupils whose parents are in receipt of supplementary benefit or family income supplement.

28. LEAs have duties also regarding the provision of adequate facilities for further education, in accordance with schemes submitted by them and approved by the Secretary of State.

29. **Powers of local authorities** LEAs have a wide range of powers to enable them to discharge their duties, subject in many cases to the approval of the Secretary of State or in accordance with Regulations made by him. LEAs' ability to exercise their powers within rating limits might be relevant to applications for derogation, since it is arguable that in conferring these powers, Parliament intended them to be exercised. Refusal of a derogation based upon a disregard of discretionary expenditure might prove vulnerable on the grounds that this was a failure to take relevant considerations into account.

30. **Other functions of local authorities** LEAs have a duty to pay awards to eligible students in higher education. This expenditure attracts Exchequer grant at the rate of 90%.

31. **Conclusions** The main implications for these duties and powers if controls were introduced on rates would probably be the following:

- i. the Secretary of State's general duty would be affected if the rating limits set for a particular authority implied a level of expenditure below that necessary for "a varied and comprehensive education service". This must be a matter of judgement in the light of the Government's national policies for education.
- ii. the Secretary of State's ability to give proper weight to non-financial considerations when considering LEAs' statutory proposals would be impaired.
- iii. the Secretary of State would be likely to receive complaints or appeals under the Education Acts from parents and others in areas where tight rating limits had led to a restricted education service.

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iv. local authorities with educational responsibilities would be likely to refer to their duties (and powers) as LEAs when applying for derogation from rating limits (education accounts for more than 60 per cent of the total expenditure of such authorities and nearly 100 per cent in the case of ILEA), and to refer to any relevant reports of HM Inspectorate.

32. Consultation between the Secretaries of State for Education and Science and for the Environment would thus seem necessary in relation to the fixing of rating limits and the consideration of applications for derogation by local authorities with education responsibilities. Special arrangements might be necessary in the case of the Inner London Education Authority (or any successor body).

NOTE BY THE OFFICE OF ARTS AND LIBRARIES

33. **Duties of the Secretary of State (exercised where appropriate by the Minister for the Arts)** The Public Libraries and Museums Act 1964 requires the Secretary of State to superintend, and promote the improvement of, the public library service provided by local authorities, and to secure the proper discharge by authorities of their functions under the Act. There is no corresponding duty in respect of local museums and art galleries.

34. **Powers of the Secretary of State** If, after holding a local inquiry, the Secretary of State is satisfied that a local authority has failed to carry out its duties in respect of public libraries, he may make an order specifying how and when these duties are to be discharged. This power has so far not been exercised.

35. **Other functions of the Secretary of State** The Secretary of State appoints members to the advisory council (LISC) established under the Act to advise him on all library matters. Financial assistance from Voted funds towards the purchase of objects for local museums and galleries is provided. The Museums and Galleries Commission (MGC), a non-statutory body appointed by the Prime Minister and funded by OAL, has certain advisory and executive functions in relation to local museums and galleries. The Minister for the Arts also has a general policy interest in promoting the arts at the local as well as national level.

36. **Duties of local authorities** Every library authority is required to provide a comprehensive and efficient library service for all persons desiring to make use of it.

37. **Powers of local authorities** The duty imposed by the 1964 Act in respect of library services is so general that no additional powers of provision are conferred on authorities. Authorities are prohibited from charging for library services other than those specified in the Act: in particular, charges for ordinary book-borrowing are not permitted. County and district councils have powers to provide and maintain museums and art galleries. The 1964 Act empowers them to charge for admission subject to certain conditions.

38. **Other functions of local authorities** Library authorities may provide on an agency basis library services to prisons, hospitals, and schools. Many authorities also provide (under separate powers) for other arts facilities in which the Minister for the Arts has a general policy interest. They may also provide assistance for institutions which are jointly funded eg by universities and local authorities.

39. **Implications of controls over rates** Controls over individual authorities' rates would not have a predictable impact on each service, as authorities would have to establish their own priorities within the limits set. It may be assumed that statutory duties would be considered a first call on resources. There is a potential risk of conflict between the library service duties and rating limits. How far this would occur in practice would depend on the tightness of the limit, the existing level of provision, and the relative priorities attached to different services. In general, however, it would be difficult for an authority to argue that a failure to provide a 'comprehensive and efficient' library service was caused by a particular overall rating limit, given the relatively small expenditure on this service compared with others; although it would also be difficult for the Secretary of State to make an order requiring more expenditure on this particular item without facing challenge. The Secretary of State has not so far made such an order, and the very general wording of the Act means that it would be difficult to demonstrate against legal challenge whether or not the duties were being fulfilled.

40. The local museums and "other arts" services of interest to OAL are discretionary and so pose no legal problems in this context. They would however

be likely for this reason to suffer disproportionately if authorities reacted to rating controls by concentrating on statutory services, and this could put increased pressure on the parallel central sources of financial assistance towards them. There would also be a risk of criticism from the LISC and MGC if they perceived that, overall, resources and standards were being reduced.

NOTE BY THE DEPARTMENT OF HEALTH AND SOCIAL SECURITY

PERSONAL SOCIAL SERVICES

41. **Duties of the Secretary of State** He has no direct responsibility for the provision of personal social services. These are the responsibility of local social services authorities acting under his general guidance.

42. **Powers of the Secretary of State**

a. **Powers of direction** Powers of direction in relation to the main providing statutes (eg Schedule 8 of the National Health Service Act 1977 (for mental disorders) and Sections 21 and 29 of the National Assistance Act 1948) enable the Secretary of State to direct the extent to which authorities shall exercise certain of their statutory functions.

b. **Power to hold enquiries:**

(i) The Secretary of State has power under Section 54 of the National Assistance Act 1948 to cause an enquiry to be held as he may deem necessary in respect of services for the elderly and disabled provided by local authorities under the Act;

(ii) The Secretary of State also has power under Section 84 of the National Health Service Act 1977 to cause an enquiry to be held in connection with any matter arising under that Act. This applies mainly to local authority services for the mentally disordered provided under Schedule 8 of the Act;

(iii) In the children's field, Section 76(1) of the Child Care Act 1980 gives wider powers of enquiry to the Secretary of State. This would appear to include a power of enquiry into whether or not an authority

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had made sufficient provision. Though there are no associated powers of direction, publication of findings would no doubt have a powerful influence on the authority's policy.

c. Default powers

(i) Under Section 36 of the National Assistance Act 1948, if the Secretary of State is of the opinion that a local authority have failed to discharge their functions under that Act, and under Sections 1 and 2 of the Chronically Sick and Disabled Persons Act 1970 (Services for the Elderly and Disabled) he may, after enquiry into the matter, declare the authority to be in default. He may then direct them to remedy the default, and if they fail to do so, he may make an order transferring to himself such of the functions of the local authority as he thinks fit.

(ii) The Secretary of State has similar powers under Section 85 of the National Health Service Act 1977 in respect of local authorities' duties relating to the provision of services mainly for the mentally disordered under Schedule 8 to the 1977 Act.

(iii) These default powers cannot, however, be used to enforce compliance with anything except the statutory provisions themselves ie over most of the field, they could be used where any authority was not providing any of the services; or, in the case of services where there are statutory provisions governing standards etc, where provision was inadequate in standard. But where the statutory powers are discretionary or vague as to the quantity of provision (ie most of the field, with the partial exception of the Chronically Sick and Disabled Persons Act 1970), they cannot be used to reduce authorities' discretion under the statute. This applies also to court orders sought against authorities by other interested parties (eg voluntary bodies).

d. Powers of inspection The Secretary of State has extensive powers to inspect the whole range of personal social services provided by local social services authorities. He would undoubtedly be pressed to operate such powers in relation to any authorities which made large reductions in spending on personal social services.

e. **Guidance** The Secretary of State is given power in Section 7(1) of the Local Authority Social Services Act 1970 to give guidance to local authorities on the exercise of their social services functions, but these powers could not be used to enforce any particular quantity of provision.

43. Other functions of the Secretary of State In relation to local authorities they include the power to promote research in the Health Visiting and Social Work (Training) Act 1962.

44. Duties of local authorities Local authorities have general duties under statutes and regulations to provide services for children, the elderly, disabled and mentally disordered.

45. In addition to these general duties to provide services, local authorities have certain duties in relation to individuals. Some of these arise in relation to children in care and adoptions, and may be triggered off by the courts (about one half of the children in care have been referred by the Courts). Others arise from the Chronically Sick and Disabled Persons Act 1970 which requires local authorities to make certain specified arrangements (including, for example, practical assistance in the home; provision of television, telephone or holiday) for individual persons whom the authority assesses to be in need. The Act also requires authorities to take certain positive steps to assess whether there is a need.

46. Powers of local authorities In wide fields of the Personal Social Services, especially for the elderly, disabled, and mentally disordered, local authorities' functions are expressed in terms which confer a discretion on a local authority in the provision of that service. This discretion is circumscribed by the Secretary of State's power of discretion (exercised through Departmental circulars) referred to above in paragraph 42e.

47. Implications of control of rates The local authorities responsible for Personal Social Services are the Shire County Councils and the Metropolitan District Councils (or London Boroughs). In arguing for derogations from control they could cite both the duties laid on them by statute, and the discretionary powers which the public have come to expect them to exercise, as arguments for increased resources. Arguments would also centre on numbers in the client groups to which the duties relate (the elderly, children, the disabled, referrals from the courts etc).

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48. There could also be implications for the priorities attached to different services, with statutory duties having to be fulfilled at the expense of discretionary services (eg social work support). It is also possible that expenditure could actually increase in the area of services provided under the Chronically Sick and Disabled Persons Act 1970. Expenditure is contained at present by a sensible common approach by local authorities and central government. If this common interest disappeared and authorities chose to follow the letter of the law, expenditure might increase, particularly if reinforced by court cases (eg prompted by pressure groups) to test what constituted a reasonable or minimum level of services to be provided by local authorities in sensitive areas like the elderly, the disabled, and children in care.

NOTE BY THE DEPARTMENT OF THE ENVIRONMENT

49. Duties of the Secretary of State

Housing He must make arrangements, in consultation with the district council, for the appointment of rent officers in each area. He must hear statutory appeals in some building regulations cases.

Other He must hear statutory appeals in some planning cases. He may also, in practice, be expected to take a general interest in how services are carried out in his policy area, even though he is not usually required to do so.

50. Powers of the Secretary of State

Housing to intervene to enable council tenants to exercise their right to buy;

Other to require district councils to collect refuse;

to direct authorities to discharge duties under the Public Health Act 1936;

to require an authority to perform, or to assume himself, its functions under the Control of Pollution Act 1974;

to direct the provision of sites for gypsies.

51. **Other functions of the Secretary of State** He issues guidance about service provision and authorities are required to have regard to some of this (eg on homelessness). But this does not involve detailed specification of manpower or level of service required.

52. **Duties of local authorities**

Housing district councils are obliged to consider local housing and conditions and needs with respect to the provision of further accommodation; they are obliged to help homeless people and to secure accommodation for those in priority need;

they must fix reasonable rents and manage the council houses provided;

as landlords, district councils are obliged to provide tenants with information about their tenancies and to consult them about matters of housing management;

they are obliged to sell houses to qualified tenants on favourable terms and, if requested, to provide the purchaser with a mortgage;

they must undertake slum clearance and make unfit houses fit;

they are obliged to make intermediate grants for basic improvements and associated repairs;

Other district councils must clean the streets;

county councils must license waste disposal sites, control movements of special waste, and draw up waste disposal plans;

Inner London Boroughs must collect refuse;

district councils have to enforce the Clean Air Acts, inspect for statutory nuisances, serve notices requiring nuisances to be abated and enforce them (Public Health Act 1936), and tackle noise nuisance (Control of Pollution Act 1974);

district councils must "endeavour to make arrangements" to discharge the sewerage function of water authorities;

these councils must also ensure buildings have adequate drainage and they have minor duties in connection with markets, public baths, upholsterers and cemeteries;

district councils must run and enforce the system of building regulations;

local authorities must also produce development plans, process planning applications and follow specified procedures when enforcing against breaches of planning control.

53. Powers of local authorities

Housing district councils may provide mortgages;

they may also provide grants for major improvements and for providing homes by conversion;

they may declare general improvement areas and housing action areas.

Other district councils may collect refuse (seen by many as a duty);

county councils may operate waste disposal sites.

54. Other functions of local authorities Most district councils act as water authorities' agents for sewerage.

55. Implications of control Though large in number, the duties imposed in this area are unlikely to require specific commitment from authorities in terms of type or quality of service, and hence cost. Were arguments for derogations based on any of these duties they would probably centre on:

- i. the need to maintain manpower intensive organisations of a sufficient size to carry out housing, planning, refuse and pollution control functions 'adequately'; and
- ii. priority areas for spending set by Ministers such as council house sales, speeding up planning procedures, publishing manpower and financial information; and
- iii. the revenue expenditure implications of previous capital commitments and new capital programmes encouraged by Ministers.

RESPONSIBILITIES OF OTHER GOVERNMENT DEPARTMENTS

56. A number of other Government Departments have overall policy responsibility for services provided by local authorities. These have not been investigated as they are likely to be of relatively minor importance. They would include:

- i. **Department of Trade:** Consumer services, weights and measures, protection of copyright, airports (a trading service expected to cover its costs);
- ii. **Ministry of Agriculture, Fisheries and Food:** Hygiene in the preparation of food for human consumption;
- iii. **Department of Employment/Health and Safety Executive:** enforcing the Health and Safety at Work Act in offices and shops.

STATUTORY DUTIES AND POWERS - SCOTLAND

NOTE BY THE SCOTTISH OFFICE

1. This Annex lists the more important duties imposed by statute on the Secretary of State and local authorities, and the main categories of regulations, central advice and guidance on performing duties which have expenditure implications for local authorities.

2. POLICE

i. The Secretary of State is broadly speaking responsible for law and order in Scotland. His most important statutory duty is to make regulations about the government and administration of police forces and to determine pay and allowances. He is also responsible for approving numbers of constables, cadets and non-police employees, appointments and senior officers and provision of equipment and buildings.

ii. The Secretary of State has power to direct HM Inspector of Constabulary to enquire into the state and efficiency of police forces and buildings and equipment; to withhold police grant (50% of approved expenditure) on grounds of inefficiency; to require amalgamations, mutual aid collaboration over the retirement of chief constables; to obtain information and to hold enquiries.

iii. Advice and information is provided to chief constables in the form of circulars. The annual reports which Inspectors are required to make are required to be published by the Secretary of State.

iv. The basic function of a police authority is to maintain and equip an efficient police force and ensure its proper administration. The authority are responsible, subject to approval by the Secretary of State, for numbers of constables, cadets and non-police employees, appointment of senior officers and the provision of necessary equipment and buildings.

v. Subject to the Secretary of State's approval, police authorities have power to require retirement of senior officers in the interests of efficiency but have no direct power to interfere in operational matters; they can exert considerable influence through financial control because chief constables have to justify to them new methods of policing or items of equipment.

vi. Police are provided, mainly for crowd control, for football matches and other public events.

Implications of Control

The statutory responsibilities laid on police authorities to maintain and equip efficient police forces and the Secretary of State's duties and powers to control and prescribe how this is to be done may combine to conflict with imposed expenditure restrictions. These responsibilities, duties and powers account for between 80 and 90 per cent of police expenditure; the scope for reduction is therefore marginal. Cuts affecting efficiency would be subject to adverse report by the Inspectorate. There seems ample scope for authorities to claim that expenditure reductions could not be implemented without failure in meeting the statutory duties and requirements by the Secretary of State or loss of efficiency. It is difficult to see how a reduction in an agreed establishment could be defended when the effect would be to impair the performance of duties for which the establishment has been estimated in the first place.

3. FIRE

i. The Secretary of State is responsible for the fulfilment of duties laid on local authorities by the Fire Acts.

ii. A fire authority may not vary its approved establishment without the approval of the Secretary of State.

iii. Advice about satisfactory standards is given through HM Inspectorate of Fire Services who carry out annual inspections.

iv. The main statutory duty placed on local authorities is to make provision for fire-fighting which provision would include the services of a fire brigade and equipment to meet normal requirements efficiently.

Implications of Control

To control expenditure below the level required to meet statutory duties could occasion adverse comment in a report by HM Chief Inspector. Reductions in numbers of firemen and appliances and closure of stations could only be made with the Secretary of State's consent. This would be difficult to give in the face of advice or criticism from his official advisers that any reduction in an approved establishment must compromise a fire authority's ability to carry out its duties.

4. ELECTIONS

The procedures to be followed by electoral registration officers and returning officers are strictly prescribed in legislation. Local authorities must perform these functions and have little or no freedom in the manner of their performance. Costs which arise have to be met.

5. CIVIL DEFENCE

- i. At present certain functions, mainly planning, are directly laid on local authorities by statute. A specific grant of 75 per cent is paid.
- ii. Ministers are considering extension of local authorities' functions in accordance with directions by the Secretary of State.

Implications of Control

Cuts in civil defence are not likely at present. There is already complaint that expenditure for current functions is prescribed. Increased expenditure on civil defence by direction of the Secretary of State would increase complaints.

6. ROADS AND TRANSPORT

- i. The Secretary of State has no duties in respect of the roads functions of local authorities.
- ii. He has power to issue recommendations on road construction standards and requires authorities to confirm that roads built or improved meet those standards.

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iii. Guidance, which is little short of mandatory, is issued on traffic signs and road markings.

iv. Local highway authorities have a statutory duty to manage and maintain public highways and streets and a common law duty to keep roads safe. They also have duties to secure expeditious convenient and safe movement of traffic, provide for parking and for road safety.

v. Maintenance of trunk roads and some construction and improvement are carried out by local authorities for the Secretary of State on an agency basis.

Implications for Control

Local authorities are obliged to incur expenditure to keep roads in reasonable condition and clear of hazards. They also have duties with regard to traffic management and safety measures. A conflict of interest might arise between the standards of construction required by the Secretary of State and the imposition of expenditure control on authorities. Expenditure within the duties laid on local authorities would be undertaken largely in accordance with the authority's judgement of the spending level needed to meet statutory and common law requirements.

7. TRANSPORT

i. The Secretary of State has no duties relating to local authorities' transport functions.

ii. Authorities generally have a duty to develop policies which will promote the provision of such a co-ordinated and efficient system of public transport as appears to the authority to be desirable and a Passenger Transport Executive (Strathclyde Region) has a further duty to review railway passenger services in its area and to enter into agreement to secure their provision.

iii. Authorities have power to make grants to operators in respect of the functions for which they have duties.

Implications for Control

It could be argued that authorities have discretion to make grants for public transport and rail services. In practice local and, perhaps even national political pressures tend to rule out such action being taken quickly or on a large scale.

8. EDUCATION

i. The Secretary of State has power to make an order declaring an authority in default in respect of any educational duties placed on it by statute. The Secretary of State is enabled by regulation to prescribe standards and general requirements and standards of premises. These regulations are mandatory and all authorities must conform. Power is also available to the Secretary of State (but is unlikely to be exercised by him) to require the appropriate negotiation committee to review the pay and conditions of teachers.

ii. As distinct from England and Wales, the Secretary of State lays down recommended staffing standards for primary and secondary schools. These are not monitored at school level nor has the Secretary of State set a recommended complement of teachers for each authority. Regulations made by the Secretary of State cover the inspection of schools by HM Inspectors, who may report on the adequacy of provision.

iii. Education authorities have a duty to secure "adequate and efficient provision of school education and further education". Standards prescribed by the Secretary of State regarding discharge of authorities' functions constitute statutory duties governing the level of provision of education. Statute also lays down a range of duties - eg provision of adequate facilities for physical education and for social, recreational and cultural activities, provision of child guidance centres and of clothing for needy pupils. For certain functions, eg help with transport, statute specifies minimum standards but also allows discretion for levels above the minimum.

Implications for Control

No case is known of any link between an authority's failure to perform an educational duty and the Secretary of State's control of expenditure. Some authorities have referred to the possibility of legal challenge to the use of the Secretary of State's power to claw back rate support grant on the grounds that it conflicted with statutory duties. Reports by Inspectors could lead to consideration of an order by the Secretary of State declaring an authority in default of a particular educational duty. This could be followed by legal challenge if the Secretary of State did not exercise his default powers.

9. ENVIRONMENTAL SERVICES

i. The Secretary of State has a general duty to promote the conservation of water resources and the provision of adequate supplies and a duty also to promote cleanliness of rivers through the River Purification Boards. He has a duty to secure the performance of authorities' duties in case of default and to settle appeals against authorities' decisions not to provide services.

ii. Ministers have recently agreed to set up a Hazardous Wastes Inspectorate who could make recommendations on waste disposal requiring expenditure to be incurred.

iii. Local authorities have statutory duties to provide

a. a wholesome and adequate water supply;

b. public sewers and treatment of sewage and other effluent;

c. for waste collection and disposal;

d. for public health; and

e. for minor functions, eg coast protection, clean air and nuisances. But for water and sewage duties are constrained in that authorities are not required, subject to appeal to the Secretary of State, to do anything that cannot be done at reasonable cost.

Implications for Control

Decisions by the Secretary of State in appeal cases could lead to higher expenditure by authorities. Pressure by the public for improved standards (which until now has, broadly speaking, been met) for implementation of EC Water Directives and for implementation of the Control of Pollution Act might also give rise to conflict of interest for the Secretary of State.

10. HOUSING

i. The Secretary of State's duties mainly relate to the payment of Exchequer contributions.

ii. Housing statutes do not impose any general obligation on local authorities to meet housing needs. There is a private alternative. They have limited obligations, eg to provide accommodation for homeless persons, to pay specific grants for improvements and repairs, to take action to remedy below standard housing and to deal with over-crowding.

Implications for Control

The limited obligations of authorities are unlikely to cause problems in the current situation of overall surplus of houses where the main provision of houses is from private sources. Government policy in recent years has aimed at a significant reduction in the cost of housing met by the national taxpayer and local ratepayers. There is no reason to suppose difficulty will arise from further reductions.

11. SOCIAL WORK SERVICES

i. Specific duties imposed on the Secretary of State relate to comparatively minor matters, eg to decide on placement of children considered to need training.

ii. The Secretary of State is empowered to make regulations dealing with a variety of matters relating to the statutory provision, under general guidance of the Secretary of State, by local authorities of social work functions.

- iii. A central advisory service provides professional advice on the development and regulation of social work services in Scotland to the Secretary of State, local authorities and voluntary agencies.
- iv. A general duty is imposed on local authorities under the general guidance of the Secretary of State to enforce and execute statutory provisions relating to social work. They have a general duty to promote social welfare and to offer appropriate advice, guidance and assistance and to maintain such residential accommodation as may be required. They also have specific duties, eg to provide an adequate home help service and to receive into care children who cannot be adequately looked after by their parents.
- v. Other social work functions may be discharged at authorities' discretion.

Implications for Control

The nature of the statutory provisions is such that challenge of imposed financial restraint would be likely to depend largely on judgement of the level of service which could then be provided. But there would be a serious risk of challenge if it could be demonstrated that one authority was prevented from discharging specific duties. There is reason to believe that priority would be given to protection of existing services at the expense of new or extended functions.

12. OTHER SERVICES

A number of other services are within the responsibility of the Secretary of State and other Ministers. These have not been investigated because they are likely to be of relatively minor importance.

EXCHEQUER AND LOCAL TAX CONSEQUENCES OF INTERIM AND FINAL SCHEMES

1. This Annex presents estimates of Exchequer and local tax consequences of various possible interim and final schemes. The figures start from certain common assumptions and explore the implications of the various alternatives. Three cases are presented in the Table.

ASSUMPTIONS**2. Common to All Cases**

- (a) All figures derive from the same estimates of the aggregate position for GB in 1983-84 (based on early budget information).
- (b) 1984-85 expenditure figures are projected from 1983-84 adjusting for NIS changes; poundage is assumed to increase by $4\frac{1}{2}\%$; grant is determined as a residual.
- (c) The interim scheme runs for three years from 1985-86, except in case III when it runs for only one year before a final scheme with a local tax is introduced.
- (d) The national total of rateable value increases at $1\frac{1}{4}\%$ pa (ie rate yield increases at $1\frac{1}{4}\%$ pa with a fixed poundage).
- (e) Cash expenditure rises at 5% pa from 1984-85 throughout the period. This purely illustrative assumption does not take account of any effects of different methods of financing or of methods of control.
- (f) These aggregate figures behave as if all local authorities were at the assumed average. Actual outcomes of the different schemes would vary from the assumptions in the directions indicated in the report text.

3. Part 1 - Cases I and II

- (g) Aggregate Exchequer grant (AEG) is restricted after 1984-85 to either, in case I, a 3% pa growth rate or, in case II, a 5% pa growth rate. Case I reflects a continuation of the recent trend of grant increase below

the rise in expenditure, (and from 1984-85 grant percentage is assumed to fall by about 1% pa); case II provides a rate of growth which matches the rate of growth in expenditure, (thus assuming that grant percentage remains constant (at 51.3%) from 1984-85).

- (h) Rates make up the difference between expenditure and grant in the interim period. The poundage is then frozen in 1987-88 at the then existing level and the supplementary local tax takes up the balance.

4. Part 2 - Case III

- (i) Case III is a variation of Case II above. Grant is similarly restricted to a 5% pa growth rate and rates make up the difference between expenditure and grant in the interim period. However, the interim period runs for only one year before the supplementary tax is introduced (in 1986/87) and the poundage ceiling is at the then existing 1985/86 level; leading to a shift of £1½bn pa tax burden from rates to the supplementary tax from 1987/88 on.

5. Part 3 - Case IV

- (j) Rate poundages are frozen in 1985-86 at the 1983-84 level (rate yield increases by virtue of 1½% pa increase in the rate base).
- (k) AEG takes up the balance during the interim scheme.
- (l) In the final scheme, AEG is constrained to grow at either (i) 3% pa or (ii) 5% pa after 1987-88. The supplementary local tax takes up the balance.

6. Local Tax Yields

- (m) LST yields are based on a figure of £1,750 million for a 1% LST in 1983-84, assuming that yields are buoyant with price inflation of 5%.
- (n) RFD/VED yields are based on a figure of £92½ million for one unit in 1983-84 (eg 1p on a gallon of petrol and DERV, £1 on VED for cars) and assume yields increase with annual revalorisation on the basis of price inflation of 5%.

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- (o) All estimates are based on local authorities sharing in the average yield. No assessment is provided of the Exchequer cost resulting from marginal yields being below average.

COMMENT

The Interim

7. Cases I, II and III illustrate permitted rate increase limits (Schemes A(ii), B(ii) and C and in Scotland Schemes I(b) and II(b)). In these cases grant is restricted during the interim period and the rate income limit is determined as the difference between grant and expenditure. Case IV illustrates frozen rates (Scheme A(i) and B(i) and in Scotland Schemes I(a) and II(a)), with grant meeting the difference between the rates yield and expenditure.
8. The presentation is highly stylised. It is clear that for the interim schemes, assuming a common increase in expenditure, the choice lies between Exchequer finance through AEG or additional rate income. In order to measure the additional Exchequer cost of alternative schemes it is necessary to postulate a baseline level of support which would have obtained. The Table effectively provides two alternative approaches: either (Case I) AEG would be constrained below expenditure (as in the recent past) or (Case II) its growth rate matches that of expenditure. I is a limiting case for the interim illustrations in that greater reduction in grant would lead to rate increases in excess of inflation. Lower growth in AEG might remain a policy option, and is referred to under the final scheme at paragraph 13 below.
9. The Table provides an alternative (Case IV) whereby rate poundages are frozen at the 1983/84 level and AEG takes the strain. Comparison of IV with each of I and II is provided in the Table. As against Case I, the extra cost of freezing rate poundages at the 1983/84 level would be over £3 billion by 1987/88. This would save annual increases in rate poundages of over 5½%. If, on the other hand, "the baseline" were viewed as keeping grant percentage constant from 1984/85 (Case II), the additional Exchequer cost would be nearly £2½ billion, saving annual rate increases of approaching 4%.
10. The costs of freezing rate poundages are particularly sensitive to inflation. At zero increase in local authority cash expenditure, a rate poundage

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freeze would be compatible with falling AEG support. (New and improved buildings coming onto the rating list would produce an expanding rates yield, so that grant - determined as the difference between expenditure and rates - could be reduced.) However, if local authority cash expenditure rose 8% pa the extra AEG support needed by 1987/88 would be £5bn compared to Case I and £4bn compared to Case II.

The final scheme

11. In Case III the final scheme is introduced 2 years earlier. Thus poundages are frozen at 1985/86 levels rather than 1987/88 ones (Case II) and an extra tax burden of about £1½bn at current prices is shifted from rates to the supplementary tax from 1987/88 onwards.

12. The table explores a continuation of each of cases I to IV. In case IV, where AEG has hitherto been the residual item, it is assumed that either a 3% or 5% pa growth limit would now be imposed. The Exchequer cost is presented as a continuation of the interim series.

13. The table presents the necessary local tax yields as residuals. These are converted into supplementary tax levels. The necessary minimum average tax levels to provide local income required are indicated. Actual average supplementary tax levels would exceed these minima, and average rates would be below the frozen rate poundages, in all schemes because of rounding up of supplementary tax rates. With a county area supplementary tax a substantial amount of burden would be likely to be transferred from rates to the supplementary tax. The marginal yield of an addition to existing taxes is lower than the average yield: thus an addition of say one percentage point to expenditure taxes would reduce the yield per percentage point. The figures here assume local authorities would receive the tax income on a pro rata basis. No estimate is made of the loss in tax yield for the Exchequer that this implies.

Alternative assumptions and expenditure increases

14. The table below summarizes figures of alternative expenditure growth assumptions and illustrates the sensitivity of the supplementary tax yield required.

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| | EXPENDITURE GROWTH pa | 1987/88 £bn | AEG GROWTH pa AFTER 1987/88 | 1998/99 £bn |
|---|--------------------------|----------------|-----------------------------------|----------------|
| Cash Expenditure | 3% | 31 | | 43 |
| | 8% | 36 | | 85 |
| AEG (rate poundage frozen, as Case IV) | 3% | 17 | 3% | 24 |
| | | | 1% | 19 |
| | 8% | 22 | 8% | 52 |
| | | | 6% | 42 |
| Rates Yield | | 14 | | 16 |
| Min Supplementary Tax Yield | 3% | | 3% | 3 |
| | | | 1% | 8 |
| | 8% | | 8% | 17 |
| | | | 6% | 27 |

Inflation and Expenditure in Cost Terms

15. The supplementary tax rates shown assume that inflation was at the same rate as the assumed 5% growth in cash local expenditure. This expenditure is net of rents, fees and charges. If they were rising faster than cash expenditure, they could provide a limited further cushion for grant and rate increases.

Graphical presentation

16. Figure 1 presents the AEG burden on the Exchequer in graphical terms. This shows, in effect, the envelope of schemes, with a 5% expenditure growth. It would be possible to choose a path between the outer options of case I and case IV. (Case III would follow a path parallel to case II, starting 2 years earlier.) Case II (5% increase in AEG) is one such option; another would be to place some specific percentage limitation on rates rather than imposing a total freeze. On the general assumption that local authorities could be constrained to behave in the required manner, therefore, any particular path could be chosen.

17. The presentation of the final scheme in figure 1 relates to Exchequer cost of AEG. For cases I and II it is assumed that grant continues to grow at the same rate. For case IV there are two options about AEG after 1987/88. If AEG were restricted to 3% at this point, it will be seen that the Exchequer cost would finally fall below the cost of a steady 5% rise in grant (in the 1990s).

18. Figure 2 gives the various local tax yields required to make up revenue shortfall in each of the final schemes. It brings out, in particular, the relatively similar effects of cases I and IV(i) on the one hand and schemes II and IV(ii) on the other. Thus although AEG has grown as a residual in case IV during the interim scheme, the dominant factor is the rate of growth of AEG in the subsequent period. Rate poundages are at a higher level in cases I and II, but are frozen in all cases. AEG starts from a correspondingly higher level for 1987/88 in case IV.

19. Assuming local expenditure growth of 5% pa, Figure 3 shows for the two extreme cases the local tax requirements at constant 1983/84 price levels and illustrates how rates would fall in real terms.

ILLUSTRATIONS OF EXCHEQUER AND LOCAL TAX - CONSEQUENCES OF ALTERNATIVE CASES - G.B.

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| | | | BASE | TRANSITION | INTERIM | | | FINAL | | | | | |
|---|----------------|--------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------|-------------|-------|-------------|
| | | | 1983 /84 | 1984 /85 | 1985 /86 | 1986 /87 | 1987 /88 | 1988 /89 | 1989 /90 | | 1993 /94 | | 1998 /99 |
| BASE: | growth p.a. | units | | | | | | | | | | | |
| Cash expenditure | 5% | £bn | 27.9 | 29.0 | 30.4 | 31.9 | 33.5 | 35.2 | 36.9 | | 44.9 | | 57.3 |
| PART I. RATES FROZEN AT 1987/88 POUNDAGES (Scheme A(ii), B(ii) and C) | | | | | | | | | | | | | |
| <u>Case I</u> | | | | | | | | | | | | | |
| AEQ | 3% | £bn | 14.3 | 14.6 | 15.0 | 15.5 | 15.9 | 16.4 | 16.9 | | 19.0 | | 22.0 |
| Rates yield | | £bn | 13.6 | 14.4 | 15.4 | 16.4 | 17.6 | 17.8 | 18.0 | | 18.9 | | 20.2 |
| Min. supplementary tax yield | | £bn | - | - | - | - | - | 1.0 | 2.0 | | 7.0 | | 15.1 |
| Rate poundage increase | | % | | 4.5 | 5.7 | 5.6 | 5.6 | - | - | | - | | - |
| Minimum | | | | | | | | | | | | | |
| -LST Level | | % | - | - | - | - | - | 1 | 1 | | 3 | | 5 |
| -RFD/VED Level | | units* | - | - | - | - | - | 8½ | 16½ | | 46½ | | 79 |
| <u>Case II</u> | | | | | | | | | | | | | |
| AEQ | 5% | £bn | 14.3 | 14.6 | 15.3 | 16.1 | 16.9 | 17.7 | 18.6 | | 22.6 | | 28.8 |
| Rates yield | | £bn | 13.6 | 14.4 | 15.1 | 15.8 | 16.6 | 16.8 | 17.0 | | 17.9 | | 19.1 |
| Min. supplementary tax yield | | £bn | - | - | - | - | - | 0.7 | 1.3 | | 4.4 | | 9.4 |
| Rate poundage increase | | % | | 4.5 | 3.7 | 3.7 | 3.7 | - | - | | - | | - |
| Minimum | | | | | | | | | | | | | |
| -LST Level | | % | - | - | - | - | - | 1 | 1 | | 2 | | 3 |
| -RFD/VED Level | | units* | - | - | - | - | - | 5½ | 10½ | | 29 | | 49 |

ILLUSTRATIONS OF EXCHEQUER AND LOCAL TAX - CONSEQUENCES OF ALTERNATIVE CASES - GB (cont.)

| | AEQ growth p.a. | units | 1983 184 | 1984 185 | 1985 186 | 1986 187 | 1987 188 | 1988 189 | 1989 190 | | 1993 194 | | 1998 199 |
|---|-----------------|-------------|-------------|-------------------|----------------|----------------|-------------|-------------|-------------|--------------|-------------|-------|-------------|
| | | | <u>BASE</u> | <u>TRANSITION</u> | <u>INTERIM</u> | ← | | | | <u>FINAL</u> | | | → |
| <u>PART II RATES FROZEN AT 1985/86 POUNDAGES</u> | | | | | | | | | | | | | |
| <u>Case III</u> | | | | | | | | | | | | | |
| AEQ | 5% | £bn | 14.3 | 14.6 | 15.3 | 16.1 | 16.9 | 17.7 | 18.6 | | 22.6 | | 28.8 |
| Rates yield | | £bn | 13.6 | 14.4 | 15.1 | 15.2 | 15.4 | 15.7 | 15.8 | | 16.7 | | 17.8 |
| Min. supplementary tax yield | | £bn | - | - | - | 0.6 | 1.2 | 1.8 | 2.5 | | 5.6 | | 10.7 |
| Rate poundage increase | | % | | 4.5 | 3.7 | - | - | - | - | | - | | - |
| Minimum RFD level | | p per gall. | - | - | - | 6½ | 13 | 19 | 25 | | 46 | | 69 |
| | | | <u>BASE</u> | <u>TRANSITION</u> | ← | <u>INTERIM</u> | → | | | <u>FINAL</u> | | | → |
| <u>PART III RATES FROZEN AT 1983/84 POUNDAGES (Schemes A(i) and B(i))</u> | | | | | | | | | | | | | |
| <u>Case IV</u> | | | | | | | | | | | | | |
| AEQ | 3% | £bn | 14.3 | 14.6 | 16.5 | 17.8 | 19.2 | 19.8 | 20.4 | | 22.9 | | 26.6 |
| | 5% | £bn | | | | | | 20.2 | 21.2 | | 25.8 | 32.8 | |
| Rates yield | | £bn | 13.6 | 14.4 | 13.9 | 14.1 | 14.3 | 14.5 | 14.6 | | 15.4 | | 16.4 |
| Min. supplementary tax yield | 3% | £bn | - | - | - | - | - | 0.9 | 1.9 | | 6.6 | | 14.3 |
| | 5% | £bn | | | | | | 0.5 | 1.1 | | 3.7 | 8.1 | |
| Minimum -LST level | 3% | % | - | - | - | - | - | 1 | 1 | | 3 | | 4 |
| | 5% | % | | | | | | 1 | 1 | | 2 | 3 | |
| -RFD/VED level | 3% | units* | - | - | - | - | - | 8 | 15½ | | 43½ | | 75 |
| | 5% | units* | | | | | | 5 | 9 | | 25 | 42 | |

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ILLUSTRATIONS OF EXCHEQUER AND LOCAL TAX - CONSEQUENCES OF ALTERNATIVE CASES - GB (cont.)

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| | 1983 /84 | 1984 185 | 1985 /86 | 1986 /87 | 1987 188 | 1988 /89 | 1989 /90 | | 1993 /94 | | 1998 /99 |
|-------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------|-------------|-------|-------------|
| <u>DIFFERENCES</u> | | | | | | | | | | | |
| <u>Cases I - II</u> | | | | | | | | | | | |
| AEQ | £bn | - | - | -0.3 | -0.6 | -1.0 | -1.3 | -1.7 | | -3.6 | -6.8 |
| Rates yield | £bn | - | - | +0.3 | +0.6 | +1.0 | +1.0 | +1.0 | +1.0 | +1.0 | +1.1 |
| Supplementary tax yield | £bn | - | - | - | - | - | +0.3 | +0.7 | +2.6 | | +5.7 |
| Minimum LST level | % | - | - | - | - | - | [0] | [0] | [1] | | [2] |
| Minimum RFD/VED level | units* | - | - | - | - | - | 3 | 6 | 17½ | | 30 |
| <u>Cases I - IV</u> | | | | | | | | | | | |
| AEQ (3% growth p.a) | £bn | - | - | -1.5 | -2.3 | -3.3 | -3.4 | -3.5 | -3.9 | | -4.6 |
| Rates yield | £bn | - | - | +1.5 | +2.3 | +3.3 | +3.3 | +3.4 | +3.5 | | +3.8 |
| Supplementary tax yield | £bn | - | - | - | - | - | +0.1 | +0.1 | +0.4 | | +0.8 |
| Minimum LST level | % | - | - | - | - | - | [0] | [0] | [0] | | [1] |
| Minimum RFD/VED level | units* | - | - | - | - | - | ½ | 1 | 3 | | 4 |
| <u>Cases II - IV</u> | | | | | | | | | | | |
| AEQ (5% growth p.a) | £bn | - | - | -1.2 | -1.7 | -2.3 | -2.5 | -2.6 | -3.2 | | -4.0 |
| Rates yield | £bn | - | - | +1.2 | +1.7 | +2.3 | +2.3 | +2.4 | +2.5 | | +2.7 |
| Supplementary tax yield | £bn | - | - | - | - | - | +0.2 | +0.2 | +0.7 | | +1.3 |
| Minimum LST level | % | - | - | - | - | - | [0] | [0] | [0] | | [0] |
| Minimum RFD/VED level | units* | - | - | - | - | - | +½ | +1½ | +4 | | +7 |
| <u>Cases II - III</u> | | | | | | | | | | | |
| AEQ | £bn | - | - | - | - | - | - | - | - | | - |
| Rates yield | £bn | - | - | - | +0.6 | +1.2 | +1.2 | +1.2 | +1.2 | | +1.3 |
| Supplementary tax yield | £bn | - | - | - | -0.6 | -1.2 | -1.2 | -1.2 | -1.2 | | -1.3 |

* 1 unit of RFD/VED is any combination of RFD/VED raising £92.5 mn at 1983/84 prices
 1p per gallon on petrol and derv raising £75 mn plus £1 on VED raising £17.5 mn

FIGURE 1

AGGREGATE EXCHEQUER COST OF ALTERNATIVE INTERIM AND FINAL SCHEMES

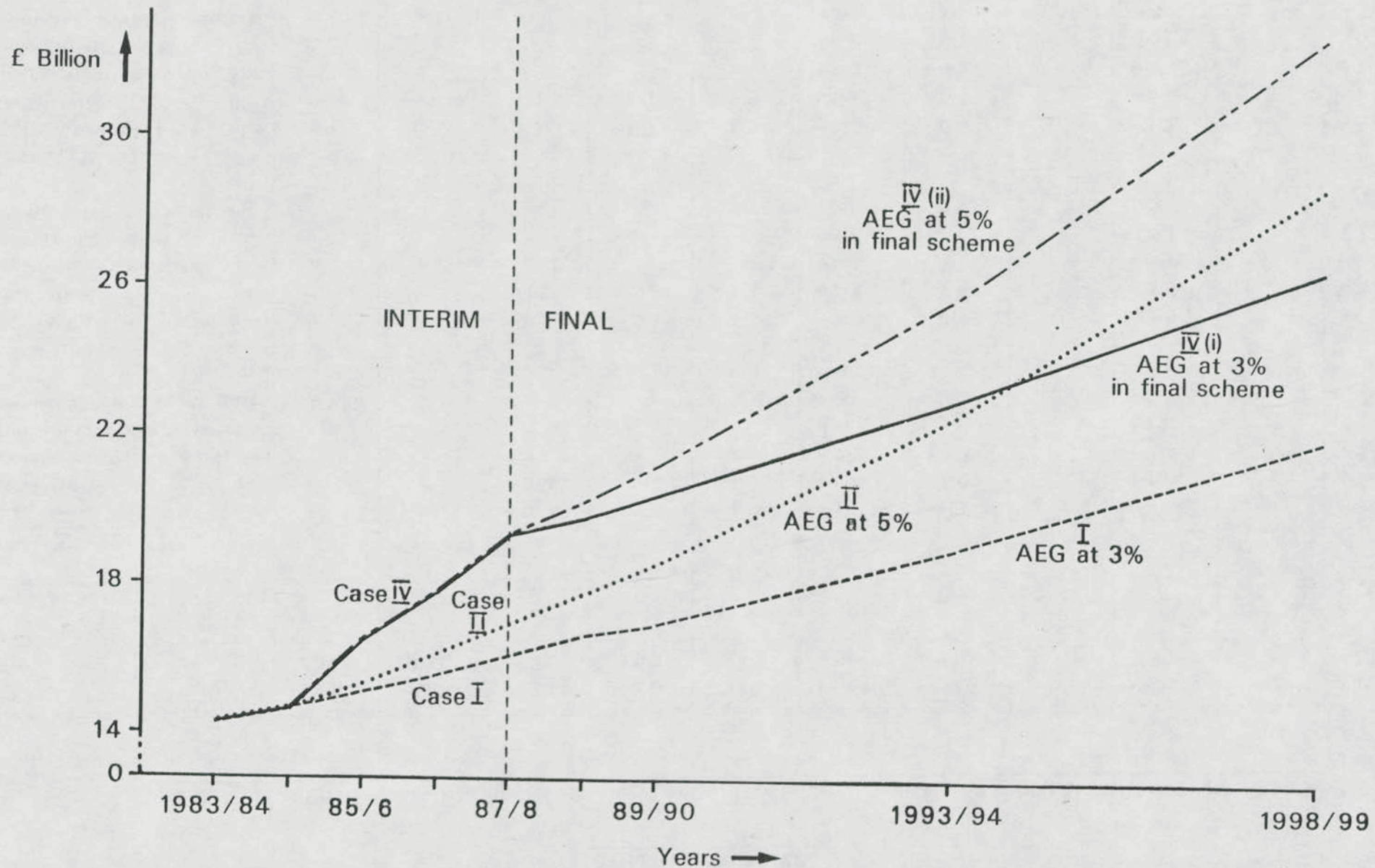


FIGURE 2

SUPPLEMENTARY LOCAL TAX REQUIREMENTS OF ALTERNATIVE FINAL SCHEMES

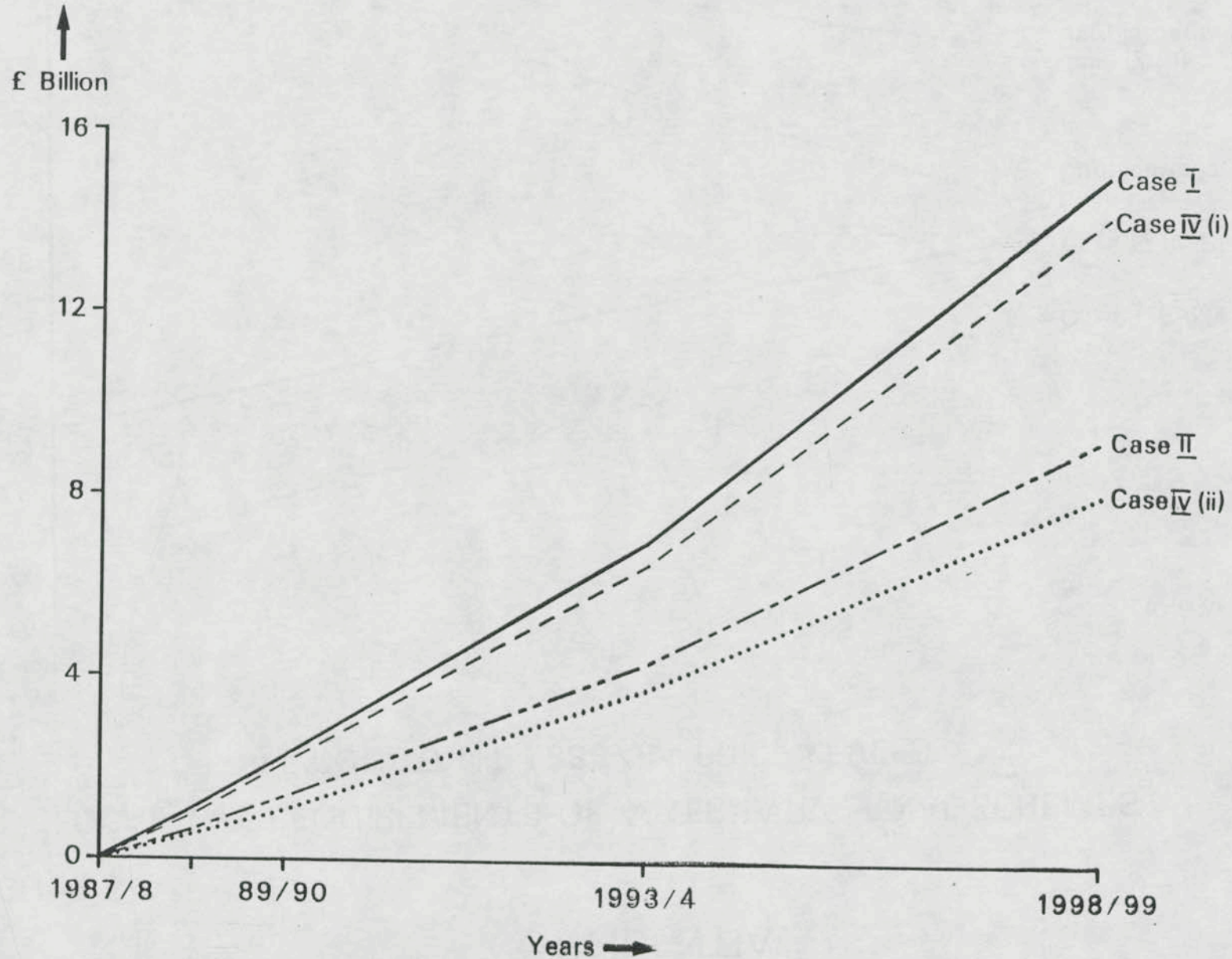
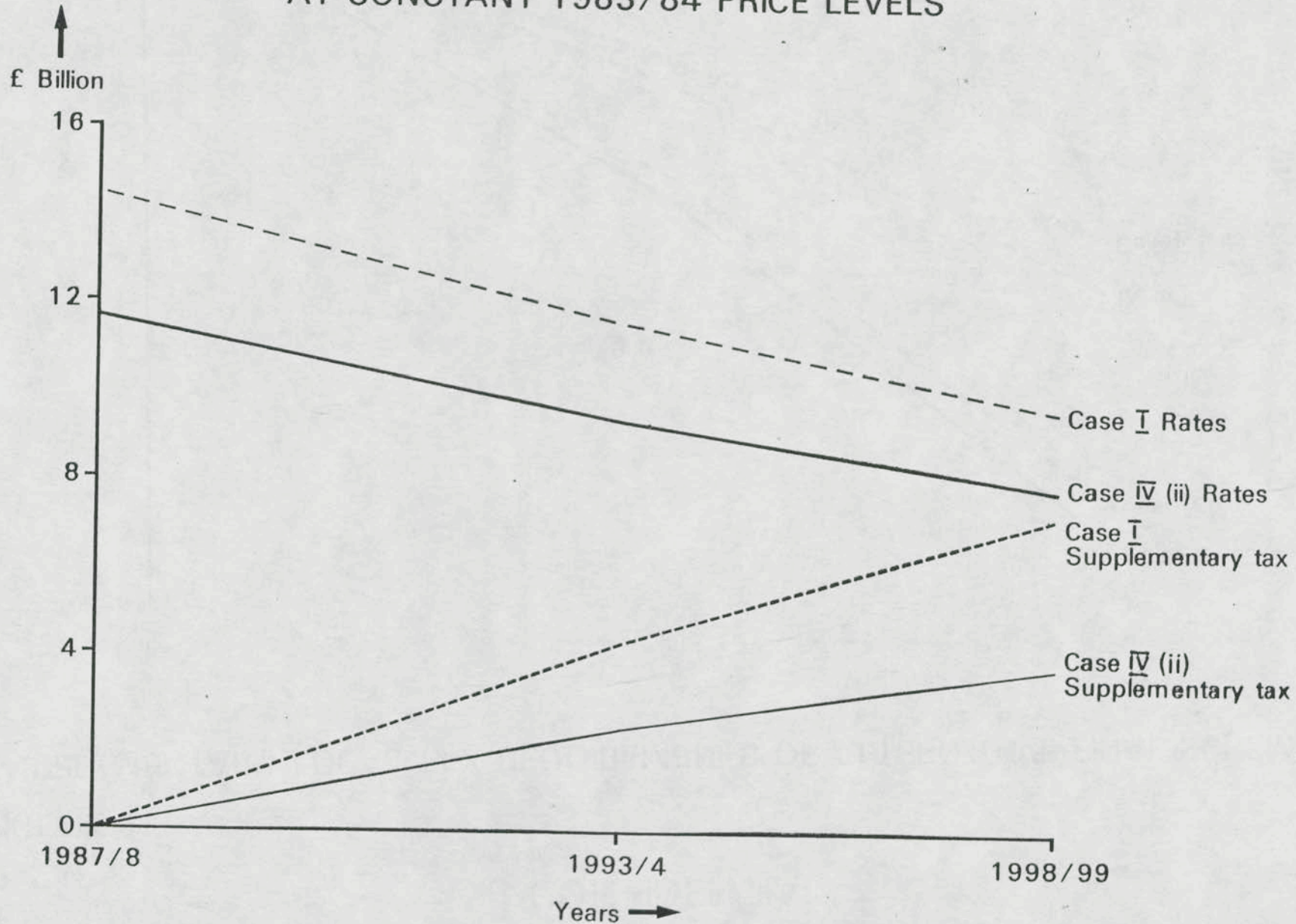


FIGURE 3

LOCAL TAX REQUIREMENTS OF ALTERNATIVE FINAL SCHEMES
AT CONSTANT 1983/84 PRICE LEVELS



CONSEQUENCES OF DEFIANCE BY LOCAL AUTHORITIES

1. Under a scheme to freeze rates or control rate increases, local authorities might decide on political grounds to defy the control and continue spending until funds dried up.
2. The first effect of this might be that they would need so much short-term borrowing to meet current expenditure that they would be unable to repay it from the current year's revenue. If so, the Council would be warned that they were in danger of a surcharge by their Auditor. If they persisted, the surcharge itself could be levied after the year's accounts were audited and it was shown that they had had to borrow excessively to meet current expenditure. Since they would claim that the surcharge only arose because of the Secretary of State's refusal to grant an adequate derogation from control, the Courts might take the view that the borrowing was justified. But in any case, the problem might arise again in the following year, when they would need to raise a rate sufficient to repay the previous year's overspend as well as to meet the new year's expenditure.
3. However, an authority is more likely simply to spend until it could no longer operate one or more services, or meet its other obligations. In that case, the Secretary of State could either
 - (a) take no action to intervene except to deal with emergencies;
 - (b) appoint a Commissioner to take on the authority's finances only; or
 - (c) appoint a Commissioner to take on all the authority's functions.

NO INTERVENTION

4. This course would leave responsibility for any breakdown in services firmly in the authority's hands. The aim would be to allow the local electorate to exert pressure on the Council to reinstate services. Central government would only bail the authority out if it accepted a rates freeze or rates increase for Year 2 to a level consistent with a "reasonable budget" plus whatever extra might have been

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granted had a derogation been sought. It would not intervene until a council would accept this condition. Law and order would have to be maintained, and limited emergency action taken to mitigate the worst effects of any local breakdown, but intervention would be kept to a minimum and central government would have to be prepared to face out uncomfortable local consequences without getting involved.

5. Creditors would probably have some redress against a defaulting authority. Unpaid contractors could sue for payment and obtain execution against the authority's goods; secured creditors, mortgagees and precepting authorities could apply through the courts for a receiver to be appointed. However, the receiver would, almost certainly have to borrow temporarily to cover the authority's debts. There is nothing in local government law which corresponds with the procedures whereby a company may be put into liquidation or an individual be made bankrupt.

6. This course would protect the Secretary of State from direct responsibility for a breakdown in local services in the hope that in the end the normal democratic pressures would bring the authority back into line. But one problem would be maintaining distance: hard cases would come forward and it would become increasingly difficult for central government to decide when and when not to take emergency action.

A COMMISSIONER FOR LOCAL AUTHORITY FINANCE

7. This approach would involve the transfer of a local authority's financial powers to a Commissioner (or alternatively the powers might still vest with the local authority but be exercisable only with the Commissioner's consent or at his direction). The functional responsibilities of the authority would remain with the Council, but the Commissioner would receive all revenues and the authority's remaining rate-making and borrowing powers would be exercisable by him. His consent would be required for all new contracts and undertakings.

8. This course would keep central government one step away from direct control over functions and might ease the problem identified in paragraph 6 above. However, there would be a risk of local electoral sympathy for the Council and non-cooperation by the officers.

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A COMMISSIONER FOR ALL LOCAL AUTHORITY FUNCTIONS

9. This course would involve in effect suspension of the authority, transferring its powers to the Commissioner. It would put responsibility for services in his hands and could therefore expose the Secretary of State more directly to blame for any breakdown.

10. Some local authority officers (either individually or through their unions) might refuse to co-operate with the Commissioner, even if they were given a statutory duty to do so. The experience of Clay Cross - where the Commissioner was in the end unable to operate even a single service (housing) and where the electorate generally supported the Council - illustrates this difficulty.

RETURNING TO NORMAL

11. In the end there would have to be a return to normal, with the local authority again taking responsibility for its functions. In the event of default by a local authority, unless central government backed down this could only happen

- if agreement was reached with the existing Council on the levels of future expenditure; or
- if the existing Council resigned; elections were held; and agreement was reached with the new Council (or the old, if re-elected) on the level of future expenditure.

When agreement had been reached, the Secretary of State might have to allow higher rates, extra grant or temporary borrowing to see the local authority through the remainder of the financial year and to resolve any outstanding problems from previous years.

12. Once a local authority had taken the path of confrontation to this point there would be no easy return to normal. There would probably be a greater chance of a quick return to normal if intervention by the Secretary of State were kept to a minimum. But if it is thought that the pressures on central government to intervene would be too great, giving a Commissioner power over finance only might be the better course of the other two.

LOCAL SALES TAX

1. This Annex examines the possible form and the technical implications of a local sales tax introduced as a supplementary tax under the final scheme described in our main report. Issues such as the potential yield and fiscal implications and the prospective gainers and losers are discussed in Section IV.

A COMPARISONS WITH OVERSEAS PRACTICE

2. In introducing a sales tax the United Kingdom would be treading a new path in aiming to combine a national VAT with a local sales tax system. No other EC Member State does so nor, as far as we can trace, does any non-EC country. As far as the EC is concerned, those Member States which used to operate forms of sales tax abandoned them many years ago in favour of VAT. Elsewhere, local sales taxes are commonplace in the United States and Canada, but operate at relatively low rates of tax and there is no VAT. Annex J explains this foreign practice in greater detail.

B MULTI-STAGE OR SINGLE STAGE TAX?

3. In theory, a local sales tax could take the form of a multi-stage tax, like VAT, which would be levied locally at all stages of manufacture and distribution. This would, however, require uniform rates of taxation and would be impracticable if local authorities were to be free to set the rates of tax locally. The reasons are as follows. It is an inherent feature of a value added tax system that businesses should be able to reclaim input tax on purchases of goods and services made for business purposes. Under a system of local taxation businesses could be expected to acquire goods and services from a number of different local authority areas at different rates of tax. If the system were akin to VAT, this would impose a very considerable burden on traders in producing an appropriate analysis of their input tax deductions in their tax return, and it would entail a major responsibility for central government in allocating input tax deductions to local authority accounts. Hence, the Group remains of the view expressed in para 5.2 of the Green Paper that a VAT-type system would prove unworkably complicated, and that a single stage model would have to be devised.

C EC CONSTRAINTS

4. Article 33 of the EC Sixth Council Directive on VAT prohibits the introduction in Member States of turnover taxes other than VAT. It has long been clear that a multi-stage tax akin to VAT would contravene the provision, but the position in relation to a single stage tax has been a matter of greater doubt. The Law Officers have recently advised that the introduction of such a sales tax would not prima facie be contrary to the Sixth Directive. They added that this was a matter, however, on which the European Court, if the matter ever reached them, would be likely to be particularly influenced by the views of the Commission. It might be advisable therefore to seek the views of the Commission before reaching a final view on the introduction of the tax.

D POSSIBLE MODELS OF A SINGLE STAGE TAX

5. Two possible models for a single stage sales tax were identified in paragraph 5.4 of the Green Paper. Under Model 1 the tax would be administered by Customs and Excise, but local authorities would be free to set the rate possibly within limits prescribed by Parliament. Under Model 2 the new tax would be collected and administered by local authorities themselves. It would be for consideration whether under Model 2 the local authorities would also be given the power to decide which goods and services should be taxable. For example, in theory at least, they might decide to tax food, heating and light, new building, public transport and young children's clothing, all of which are currently zero-rated for VAT purposes.

6. The Group took the view that the VAT-based model (model 1) should be regarded as the front-runner for detailed examination, but we have covered model 2 aspects in this Annex where significant points of distinction arise.

E TIMETABLE

7. Paragraph 5.13 of the Green Paper indicated that a local sales tax under either model could not be achieved before 1987/88 at the earliest. The loss of one year's planning time since the completion of consultations on the Green Paper means that 1 April 1988 would now be the earliest date achievable.

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8. The long lead time is necessitated for Model 1 by the complexity of the organisational and systems planning effort which would be required to intermesh a centrally collected sales tax with the existing, highly sophisticated VAT. Preparation for the new tax would also coincide with the current programme of replacement of Customs and Excise's main VAT computers which are now reaching the end of their working life. This would involve major reprogramming prior to the changeover of computer systems and the introduction of a sales tax would not be feasible until the new computers were fully operational and additional capacity could be grafted on. The computer preparations would then run in parallel with the legislative, recruitment, accommodation and training programmes which would be necessary for a complex new operation.

9. As explained in the Green Paper, a Model 2 tax would require local authorities to set up their own tax administrations which would almost certainly need to be computer-based. It would be unlikely that these could be completed much earlier than five years from the decision to proceed.

F TAX COLLECTION AND MANPOWER REQUIREMENTS

10. Collection of a Model 1 local sales tax would require tax payers to make periodic returns and payments to Customs and Excise Headquarters at Southend, as happens now for value added tax. Because of the prospective differences in coverage (see paragraphs 14-15 below) and the lack of an input tax credit mechanism a return document separate from the VAT form would be necessary. Consideration would also have to be given to requiring separate returns for each local authority area for the many multiple traders who currently make a single VAT return to cover their activity nationally. (The alternative would be a single return with a requirement for a detailed analysis to be attached.) In the interests of simplicity of administration it is highly desirable that the same basic quarterly accounting periods should be followed as for VAT.

11. The additional Customs and Excise manpower requirement for a Model 1 sales tax would be in the range of 2,000 - 3,000 additional staff, depending on the precise form of the new tax. Of these, approximately 1,100 would be employed at the VAT Headquarters in Southend dealing with the computerised handling and processing of returns, credibility checking and so forth. This would represent a virtual doubling of the size of the VAT Central Unit (from a reduced base which

takes account of recent efficiency savings) in line with the doubled paper-handling requirement. The rest of the additional staff would be employed locally in dealing with the increased control and enforcement work, and dealing with taxpayers' enquiries and problems. The Group assume that local authorities would be required to meet the central administrative costs of running a Model 1 sales tax.

12. For a Model 2 sales tax businesses would make their returns direct to the local authorities concerned. Questions such as the length of accounting periods could either be left to local authorities to determine or could be prescribed by Parliament in the interests of securing a measure of harmonisation with VAT. It is impossible to estimate the aggregate manpower requirements for local authorities under Model 2, but it can be said with confidence that they would be a good deal higher than for Model 1. On the other hand, a Model 2 sales tax would be less vulnerable to industrial action than Model 1, which would concentrate a large extra slice of revenue collection at Southend (chosen twice in recent years by the unions as a prime target for selective strikes).

G. BUSINESS COSTS

13. Introduction of a sales tax would inevitably involve substantial additional compliance costs for businesses particularly for smaller traders who are already the most vociferous in complaining about the accounting burden of VAT. No official study has been made of the compliance costs incurred by businesses because of VAT, but an academic study made by Professor Sandford and his fiscal studies unit at Bath University in 1977/78 estimated gross compliance costs at about £400 million in that year. The report also confirmed that VAT compliance costs are highly regressive - the average compliance costs of traders with less than £20,000 turnover (which includes many voluntarily registered traders) was estimated at some thirty or forty times more as a proportion of taxable turnover than of traders with over £1 million taxable turnover. The compliance costs of a local sales tax would also tend to bear disproportionately heavily on small businesses. The political objective would be to compensate for the increased compliance burden on businesses through the ceiling on non-domestic rates; the regressivity of compliance costs in relation to smaller businesses would be a complicating factor in this regard.

H DEFINITION OF A SALES TAX: BUSINESS PURCHASES

14. Paragraph 5.5 of the Green Paper recognised that a major problem with a sales tax would be that of defining the transactions to which it applied. In principle, if a sales tax were to act as a supplement to both domestic and non-domestic rates, it should be so designed that an effective burden fell on both households and business consumers of goods and services alike. It could be argued in theory that since businesses could normally be expected to pass on the burden of indirect taxation in the form of higher prices, the coverage of the tax should be limited in its application to goods and services purchased by households; but in that case the rate of tax would have to be higher than it would be for a more comprehensive coverage including businesses, and it might be regarded as imposing an unacceptably large direct burden on households by comparison with domestic rates.

15. At the same time it has to be recognised that the coverage of a sales tax could not be totally comprehensive. If no relief were to be given for business purchases under a sales tax, there would be substantial economic distortions because of the cumulative effect of charging tax at successive stages in the process of manufacture and distribution, which would tend to give an artificial fiscal incentive to vertically integrated industries and to imports. It is not easy to strike the appropriate balance, but we think that in order to minimise distortion it would be necessary to exclude from the coverage of the tax at least goods for resale and, if the problems of definition could be overcome, probably also capital goods, semi-manufactures and components for incorporation in other goods. On the other hand, some items which are widely purchased by businesses should almost certainly be included in the coverage. A list would include road fuel, stationery, telephones and virtually all services which are at present subject to VAT. From the point of view of the business consumer this would be part of the price to be paid for a ceiling on non-domestic rates, but there would inevitably be gainers and losers as between individual businesses.

16. Customs and Excise are examining two ways of achieving the desired coverage effect. One way would be to apply the tax to the business of "retailers". This would virtually automatically exclude most business purchases of goods at the semi-manufacture and wholesale stages, but a wide and to some extent artificial definition of such terms as "retailer" or "retail sale" would need to be adopted in order to tax business services and other business purchases of quasi-retail

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character. Further deeming provisions would be needed to reduce the incidence of anomalies and the scope for avoidance - eg in order to tax reduced price sales of cars by a car manufacturer to its own employees.

17. The alternative approach would be to start off with a very wide charging provision on the lines of VAT, and then specifically to exempt those transactions such as the supply of goods for resale etc which it was intended not to tax. The main problem with this approach would be to minimise the opportunities for avoidance and evasion since there have always been difficulties in requiring traders to determine liability to indirect tax according to the use to which the customer intends to put the item supplied. Most American States are thought to deal with these problems by the issue of exemption certificates to authorised businesses. The use of such a device here would not, however, sit entirely happily with VAT which relies on the input tax credit mechanism effectively to exclude most transactions in the business sector.

18. Further work will be needed to evaluate the respective merits and drawbacks of these two approaches and to determine which should be preferred.

I EXPORTS AND IMPORTS

19. Exports of goods and certain international services would be exempt from sales tax, probably under similar arrangements to those which provide zero-rating for exports under VAT. There would almost inevitably be some burden of "sticking" tax on exported goods, which could be more visible than in the case of rates. The extent of this burden would depend on the scope of exemptions for transactions in the business sector (paragraphs 14-15 above).

20. As explained in paragraph 14 above, there is a risk that a sales tax could discriminate in favour of imports, particularly of finished goods which would suffer no sticking tax burden. There seems to be no practicable form of compensatory taxation here. As regards non-finished goods, if there were wide exclusions from the sales tax base for intermediate transactions within the business sector, these would have to be matched for importations; but equally if, say, domestically manufactured components were to be taxed, the same should apply to imported components. A compensatory tax of this nature should not in principle be contrary to our international obligations in the European Community, or more widely under GATT provided the import charge could be shown to do no more than

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offset the burden on domestically produced items, but there could be practical difficulties in its operation which would need to be examined. There would also be problems in determining the rate of tax to apply at importation. There seems to be no logical reason why this should be the rate in force for domestic sales in the area in which the port or airport of importation is located. Consideration would have to be given to alternative solutions: one possibility might be to fix the rate nationally (possibly as a weighted average of current local sales tax rates). It would then be for consideration whether the tax collected in this way should form part of ordinary central Government revenues, or whether it should be redistributed by the Department of the Environment to authorities as an appropriation in aid of the rate support grant.

21. Careful consideration would also need to be given to the compatibility of treatment of imports for sales tax purposes with the postponed accounting system for tax on imports which operates for VAT, and which we are currently seeking to encourage as a Community-wide standard, through our support for the draft Fourteenth Directive on VAT. There would clearly be no problems if there were no sales tax charges on importation. On the other hand, if certain categories of goods were to be chargeable on importation, it would be desirable in the interests of simplicity of administration to explore the scope for deferring the charge for sales tax as for VAT. Otherwise the normal Customs and Excise handling of import transactions would be considerably complicated. Further examination will be needed of the practicalities of integration with the VAT system.

J REGISTRATION THRESHOLD

22. The Group's view is that it would be necessary in the interests of simplicity to have the same registration threshold as for VAT, which is currently £18,000 a year. The adoption of a lower limit for sales tax purposes would involve the registration of some hundreds of thousands of very small businesses who have been purposely kept out of the VAT system, since they offer little revenue potential and in many cases would not be well equipped to cope with the accounting requirements which VAT entails. At the same time it would have to be recognised that adoption of the VAT registration threshold for sales tax would exacerbate the distortive effects of the tax between small businesses on either side of the borderline (which have already led to complaints in some sectors such as the construction and hotel trades) since unregistered businesses would then enjoy a greater competitive advantage.

K RATE OF TAX: ROLE OF LOCAL AUTHORITIES

23. In principle this would be left to the local authority to determine under either model, possibly subject to a ceiling to be fixed by Parliament. For the reasons explained in para 5.22 of the Green Paper in order to avoid excessive disruption for taxpayers it would be necessary to consider the possibility of limiting the frequency with which authorities could make variations in the rate of tax (eg to once a year).

L "LUMPINESS"

24. Paragraph 5.21 of the Green Paper suggested that local authorities should be allowed to charge tax in steps no smaller than 1%, although steps of whole percentage points would cause budgeting problems for authorities because of the "lumpiness" of the tax yield (eg at a 3% tax rate a change of one percentage point in the rate would change the tax yield by as much as one third). Many businesses, particularly the smaller ones, already experience difficulty in accounting for VAT: according to their circumstances they may be required to add VAT to tax-exclusive prices or to work from tax-inclusive prices. They would undoubtedly have problems in operating a tax rate which involved fractions of a percentage point, and the incidence of error and confusion could rise appreciably. This would inevitably add to the unpopularity of the tax system. From the point of view of tax administration it would therefore be highly desirable to avoid fractional rates or percentage points. On the other hand, steps of whole percentage points would pose severe budgetary problems for local authorities because of the lumpiness of the sales tax yield. It would also make it much harder to retain the concept of resource equalisation between authorities. Section IV of the report suggests that the scope for allowing rates of tax to vary by up to a single decimal point of 1% could be made an issue for consultation.

M TAX BASE

25. As explained in paragraph 5.7 of the Green Paper, the interaction between the rate of local sales tax and the VAT rate would be a probable source of difficulty which it would not be easy to resolve. Under the EC Sixth Directive, VAT has to be charged on a base which includes all other duties and taxes. If this rule were to be applied to sales tax, it would involve

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considerable additional difficulty for retailers who would have to work with a composite rate of tax involving a figure set to several decimal places (contrary to the arguments explained in paragraph 24 above). The Group therefore believe it would be desirable to seek a derogation from the EC Commission to allow VAT and sales tax to be charged in parallel. It cannot, however, be guaranteed that it would prove possible to obtain this derogation; and even a tax base operated in this relatively simple way would not be free from difficulties for the retailer who worked from tax-inclusive prices.

N NUMBER OF AUTHORITIES

26. The problem of collection of a model 1 tax would not be qualitatively different whether sales tax was charged at county or district level, or even on a joint basis provided the rate of tax could be composited. (It would be highly undesirable to have separate county and district systems of sales tax running in parallel and requiring separate returns.) However, the administrative costs under either model would be increased if the tax was to be operated at district level, and compliance costs would probably also be greater, at least for multiple stores and others with a wide geographical distribution of retail outlets. The implications for local authorities are discussed in Section IV.

O PERCEPTIBILITY

27. Like VAT, a Model 1 sales tax would not be very perceptible. For the reasons explained in paragraph 5.16 of the Green Paper, a requirement for traders to show sales as a separate item on bills and receipts would be impracticable. An annual local authority explanation, as discussed in paragraph 5.17, seems a much more promising solution. A Model 2 sales tax might be regarded as rather more perceptible in the sense that collection by local authorities could create a greater link with local expenditure, but cross-border shopping could render accountability less than complete.

P REVENUE YIELD

28. The revenue yield from a sales tax at any given rate would be very difficult to forecast both nationally and for individual authorities. It would vary with national and local economic conditions, but the difficulties associated with cross-border shopping would make the yield even more difficult to predict. This

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uncertainty could tempt authorities to pitch rates too high, in the early days of the tax. The problems of anticipating yield accurately are likely to prove particularly difficult if over time sales tax were to replace rates completely, and not just act as a supplement.

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SALES TAX: PRACTICE ABROAD

1. As explained in paragraph 2 of Annex I, none of our EC partners operate a local sales tax. Some do, however, have minor local excises and other taxes of very limited scope. In the United States, state (but not federal) revenue is largely funded by retail sales taxes. As we understand it, nearly all of those operating a general retail sales tax have adopted the legislative approach to imposing tax on all sales of tangible personal property and then making exemptions for social reasons (eg food, medicine) or to reduce the burden on business costs (eg goods for resale). Nevertheless, it appears that a not inconsiderable proportion of business purchases are subject to tax and that some "cascading" occurs. The states also operate a "compensating use tax" at a rate equal to the sales tax which applies in principle to all purchases by state residents in other states or from abroad. In practice, however, we understand that the revenue authorities have great difficulty in enforcing this requirement.

2. Sales taxes are also found in Canada and, at the national level but with limited coverage, in Japan. The so-called Commonwealth sales tax in Australia is a wholesale stage tax very similar to the former UK purchase tax.

3. Brief details of the US and Canadian taxes are as follows:-

USA State sales taxes in 45 states (and extensive local sales taxes in Alaska)

26 states also have additional local sales taxes

Maximum combined rate 8%

Maximum state sales tax rate 7%

Maximum local sales tax rate 4%, except in Alaska, where 5%

Range of various exemptions, mostly covering food

- drugs

- manufacturing equipment

- agricultural equipment

In most cases, local sales taxes collected by the State authorities (2 or 3 exceptions, most notably Louisiana).

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Canada Provincial sales tax in all but 1 province

Rates range from 5% to 11%

No other local sales taxes

Fairly wide range of exemptions, including - food
- drugs
- some clothing

Tending more towards semi-luxury consumption taxes.

SUPPLEMENTARY LOCAL EXCISE DUTY ON ROAD FUEL

1. This Annex examines the form and technical implications of a supplementary local excise duty on road fuel as a source of local authority revenue under the final scheme described in the Group's main report. Issues such as the potential yield and fiscal implications and the prospective gainers and losers are discussed in Section IV.

A PREVIOUS CONSIDERATION

2. Layfield looked at the road fuel duties as possible sources of local government finance and rejected them for reasons of lack of accountability and burden on business costs. The 1981 Green Paper rejected (Annex A, paragraphs 2-6) the idea of local duties on petrol, together with alcohol and tobacco for reasons of practicability and costs.

B GENERAL

3. The concept of a supplementary local duty on road fuel would be new to the United Kingdom, but not unprecedented. In the United States, for example, there are both federal and state excise duties on gasoline, albeit at lower levels of taxation than apply in the UK. The addition of a supplementary local duty would be bound to lead to some reduction in central government revenue because of the consequential fall in demand. Moreover, the effect of a duty with both a central and a local government element would inevitably be to complicate the administration of the tax for traders and the tax-collecting authority alike.

C SCOPE AND DEFINITION

4. Any attempt to restrict the application of local rates of duty of any size solely to petrol would encourage a switch to locally untaxed derv-driven vehicles. We think it would therefore be necessary to charge both. This would result in a charge on freight as well as passenger transport, but there would be some competitive effects in the transport sector. Long distance coaches would bear increased costs, as would taxis, but at present local bus services are effectively exempt from duty through the stage bus fuel grant. Railways and

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airlines would also be unaffected since they rely on heavy oils taxed at the "rebated" rate (of 3½p a gallon) which we envisage would not be subject to local duty.

5. The question of definition of a local duty would need careful consideration. The national duty on petrol is not an excise duty on use as a road fuel; it is a duty on light oils. Thus it falls on petrol used, for example, by foresters, but it may be reclaimed by fishermen. Light oil used as solvents or in manufacturing processes is exempt and, subject to conditions, oil used as furnace fuel bears duty at only 3½p a gallon. Derv, on the other hand is dutied specifically as a road fuel, but other heavy oil, such as that used in farmers' tractors, is dutied at 3½p a gallon. For ease of administration and collection there would be a case for requiring the pattern of charge of a local duty to mirror exactly the national excise duty charge and relief pattern.

6. An alternative form of the duty would be to seek to charge petrol as well as derv directly as a road fuel. There are two possible approaches to doing this. One would be to define petrol technically by reference to its physical characteristics, as is done at present for light oil. This would require further technical examination; it would involve difficulties, and Customs and Excise would have to consult the Government Chemist. The second possibility would be to limit the charge to oil used as road fuel. This would circumvent difficulties of definition for petrol, but the end-use criterion would give rise to serious practical problems of control and administration in order to prevent abuse. These problems would be much more severe for petrol than are currently experienced with derv.

D TAX POINT

7. The Group has examined three possible ways in which a supplementary local duty might apply. These are:

- (i) maintain the present duty point and collect the national duty and local duty together, simultaneously allocating the local duty to the local authority in which the duty point is situated. Because of the high rates of the duties and the incentive for evasion, duty is currently charged at an early stage, ie when the goods leave refineries or other specially approved premises for distribution to

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the UK market. The total number of duty points is therefore relatively small (about 220 in all) and so this scheme would be relatively cheap to operate. The distribution of revenue according to the location of refineries and other premises would, however, produce very inequitable results (eg there are very few approved premises in the GLC area), and it would almost certainly be necessary to collect the revenue centrally and redistribute it between all authorities according to a pre-determined formula. This would result in a scheme closer to an assigned revenue than to a genuine local tax.

- (ii) maintain the present duty point, but allocate revenue from the local duty on the basis of the destination of deliveries. This method, like (i), would minimise evasion before the duty point, and would attempt to relate the allocation to the authority in which the road fuel was sold. The point of sale could not, of course, be an accurate proxy for consumption (see paragraphs 9-10 below), and there would be major difficulties both in principle and practice in requiring traders to allocate tax on a destination basis. It could be politically difficult to lay responsibility for allocation of tax to traders, and they may well lack the necessary information to do so accurately. Moreover, there would be a substantial practical reduction in scope for local variations in rates of tax. With a locally variable duty, there would need to be a considerable co-ordinated control effort to ensure that goods dutied on the basis of delivery on a low-taxing authority were not diverted to a high-taxing authority. Unless the allowable latitude in rates of duty was strictly limited, we consider that this form of evasion might prove insuperable. We are driven to conclude, therefore, that this method is not a practicable one.
- (iii) Move the tax point for the local duty to the retail stage. This method would allocate revenue to the authority in which road fuel was sold by retail. It would greatly increase the number of duty points and therefore the problems of accounting and control. For the trader, it would require separate records to be kept and separate returns to be completed, in addition to those already needed for VAT. For the tax collecting authorities, it would require the control of about 25,000 petrol stations together with substantial additional numbers (possibly about as many again) of distributors and contract customers

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for derv. Each trader would have a responsibility to declare the current amount of duty, but the maximum opportunity and incentive to under-declare it. If control was to be effective, it would impose a substantial manpower requirement on the collecting authority and would therefore be costly.

8. The Group's view is that, notwithstanding the difficulties, a supplementary local duty to be used as a local revenue would have to be collected at the retail stage. It noted, however, the advice of Customs and Excise that, if as a result of further work or over time, the rate of duty needed to provide sufficient revenue to local authorities was found to be more than the equivalent of a few pence per gallon, consideration might have to be given in the interests of security of the revenue to a two-tier arrangement. This would aim to reduce evasion at the retail stage by collecting part of the "local" duty (which in practice would need to be less than the minimum rate levied by any local authority) at the limited number of national duty points, presumably by Customs and Excise staff, leaving retail stage collection to cope essentially with the local variable element in the duty. The first stage of the duty would then be distributed by means of a formula related to the tax base in each local authority area as verified from returns from the retail stage part of the duty. Local authorities would be re-charged the collection costs attributable to their share of the revenue.

E ACCOUNTABILITY, PERCEPTIBILITY AND CROSS-BORDER SHOPPING

9. The criteria which have been followed since Layfield are that the level of any local source of revenue should be set locally, be related clearly to local expenditure, and the effective burden should not be borne substantially by people outside the area concerned. If these criteria are applied to the preferred method (iii) scheme of collection, there is no doubt that this would allow the level of the duties to be set locally and could be related to local expenditure, provided that the authority did not seek to meet local needs by setting much higher rates than those prevailing in surrounding authorities. If it did so, there would be a falling off in purchases of the goods involved, because consumers would arrange to top-up their petrol tanks whenever they visited another authority (which for commuters, might be every day). In addition, firms would be likely to try to set up their fuelling depots within low taxing authorities (and it must be remembered that a substantial proportion of derv is purchased by users direct from oil companies and never passes through the "retail" stage).

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10. In general, because of the narrowness of the tax base and the inherent mobility of cars and lorries, we would regard the scope for cross-border shopping as greater than with a more widespread sales tax. Road fuel has been very price-competitive in recent years, and the motorist could prove to be highly sensitive to even small variations in the rate of local road fuel duty feeding through into prices. There would be a limit therefore to the extent to which rates of road fuel duty could be increased to meet local needs. The problem would be most acute if lower tier authorities were allowed to set rates of duty, when duties would be paid by many non-residents, eg in urban shopping or office centres in shire counties. But even if only top tier authorities set rates, a substantial proportion of the duties would be paid by non-residents. In either case the garage petrol supply trade could be affected substantially because of the fortuitous location of a boundary.

11. In the absence of special measures a local duty on road fuel would not be very perceptible. Prices of road fuel would increase on introduction or upward variations of the local duty, but it seems unlikely that most consumers would be conscious of how much local duty they were paying. A statutory requirement for the issue of itemised invoices would be burdensome and unpopular. Consideration might be given, however, to a requirement for display of local rates of duty at filling stations in reasonably prominent positions where they would be seen by most customers.

F DISTRIBUTIONAL CONSIDERATIONS

12. About two-thirds of all petrol is purchased by consumers, about one-third by businesses. Virtually all derv is purchased by businesses. Assuming both commodities were taxed, this would result in slightly more than one-half of total duty accruing from consumers, and slightly less than one-half from businesses. This would reverse the present relative contributions from rating. The effect on household incomes is discussed in Section IV.

G RESPONSIBILITY FOR COLLECTION

13. The Group's view is that responsibility for collecting a local duty on road fuel should rest with the local authorities. A case could be made out, given appropriate charging provisions, for using HM Customs and Excise, which already has an infrastructure of VAT and excise duty controls, but a local duty would

inevitably impose an additional manpower requirement and there seems to be no reason of principle why this should not be taken on by the local authorities themselves. Moreover, a control responsibility vested in the local authority could provide a greater link with the provision of local services and improve the perceptibility of the tax. As noted in paragraph 8, however, with a two tier collection arrangement Customs and Excise would probably be best placed to collect the first national tier of duty, recharging authorities for the service.

H ADMINISTRATIVE COSTS

14. The cost to Customs and Excise of administering the excise duties on road fuel in 1981-82 was about £8 million or 0.2% of the revenue. The duty is one of the cheapest indirect taxes to collect. A supplementary local duty collected by local authorities at the retail stage would inevitably, however, be more expensive. It would require individual retailers to be visited and their operations tightly controlled. Any estimate of costs is inevitably speculative, but the current cost of controlling garages for VAT purposes is about £1½ million a year and this would probably need to be grossed up several times for sales tax. VAT control visits take place at intervals varying from annually to once every eight years; under a local excise duty the objective would probably be to visit all traders at least annually. Allowance would also need to be made for the central costs of collection in each local authority area. The Group think it unlikely that aggregate costs of collection would be below a range of £10 million - £15 million.

I COMPLIANCE COSTS

15. The present national duty is charged at about 220 central points. A retail stage local duty would inevitably impose considerable additional compliance costs on the 50,000 or so distribution points in the UK which, as explained in paragraph 7(c) above, would need to keep detailed records and complete separate duty returns in addition to those already required for VAT. The total costs are impossible to estimate, but would no doubt be significant in relation to the businesses concerned.

J FORM OF NEW DUTY

16. The Group has considered whether a new duty would be better charged on a specific or an ad valorem basis, and has concluded that a specific duty (like the

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present national excise duty) would be preferable. Such a duty would be expressed at a rate of pence per litre and it would be effectively revalorised annually as local authorities determined their revenue needs for the coming year. Subject to that, however, it would provide a more certain and readily verifiable basis of taxation. Retail stage collection would, in principle, lend itself to the alternative approach of an ad valorem duty, but there would be a number of difficulties. An ad valorem duty would exacerbate existing price differences between various forms of retail outlet or between regions (in contradistinction to the views of the Select Committee on Scottish Affairs which last year recommended the zero-rating of VAT on petrol in order to reduce regional differences). It would also be vulnerable generally to further price discounting (particularly for bulk purchasers of derv) at the partial expense of the revenue, and this could add to the problems of forecasting for local authorities. For these reasons the Group does not recommend it.

LOCAL VEHICLE EXCISE DUTY

1. This Annex examines the possible form and the technical implications of a local vehicle excise duty used as a supplementary tax under the final scheme described in the main report. Issues such as the implications for the Government's fiscal strategy and the potential gainers and losers are discussed in Section IV.

A A SUPPLEMENT TO A NATIONAL DUTY OR A LOCAL DUTY? .

2. The total yield from Vehicle Excise Duty (VED) in 1983/84 at current duty rates is expected to be about £1940 million, of which about £1500 million would accrue from VED on cars, motor cycles and light vans (under 1½ tons). If local VED were to operate as a supplement to national rates of duty it would be necessary in order to raise, say, £1 billion revenue to add about £60 to the cost of a car licence. At present rates of VED, the level of evasion is probably just within the bounds of ensuring that VED as a tax does not fall into disrepute. An increase of £60 in the cost of a licence would be likely, however, to lead to a very significant increase in evasion. The Group concludes that this points to one duty which, subject to paragraph 3 below, might predominantly be a local duty.

B COVERAGE OF LOCAL DUTY

3. VED essentially performs two functions: in its application to cars and light vans it is basically a revenue raiser; while its application to heavy goods vehicles is a policy instrument designed to ensure that each class of lorry at least covers its allocated road costs through the taxation it pays (derv duty and VED) in line with stated policy and the recommendations of the Armitage Committee. To allow local authorities to set VED rates for lorries would mean losing control of a major plank in this policy, and would make it impossible for the UK to comply with the proposed EC Directive on Adjustment of National Taxation Systems for commercial vehicles (ANTS). There would also in any case be practical problems for local authorities in devising and publishing comprehensive schedules of VED rates for the many and varied types of heavy goods vehicles on the roads. The Group suggest that a practicable way of preventing these

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difficulties from arising would be to preserve a national rate of VED for heavy goods vehicles, set by central Government; but to devolve to local authorities VED on cars, motor cycles and light vans.

C LOCAL RATES OF VED

4. Although the rate of VED on cars has tended to be altered in units of £5, there is no reason why smaller variations should not be made - although for simplicity changes of under £1 might be ruled out.

5. In practice, because of the possibility of registered keepers of cars attempting to pay their VED in the most favourable tax area, the rate of VED on cars would probably tend to be set at roughly the same level by local authorities. It would nonetheless be necessary to consider whether special arrangements were needed to ensure that company cars were registered at their place of use and not at the place most financially advantageous to the company. It would probably have to be accepted that other fleets - eg of hire cars and distributors' vans would be registered in those areas with lower levels of VED.

6. VED is currently charged at a flat rate, rather than based on engine size or any other criterion. If local authorities were allowed to change the structure of the tax, this would lead to serious administrative complications for post offices and DVLC. For this reason the Group believe it would be necessary to reserve changes in the structure of VED to Central Government.

D ADMINISTRATION

7. Currently the Department of Transport's Driver and Vehicle Licensing Centre at Swansea (DVLC) maintains a central register of all vehicles, and keepers, from data collected as a by-product of VED licensing, and sends out VED renewal reminders to all keepers. The central register is used extensively by the police and for safety purposes and it would be essential under any system of local VED for the central register to be retained.

8. By the time the necessary legislation was enacted, the existing records of DVLC could be analysed to produce a fairly accurate allocation of the VED revenue to counties in which cars were registered. But considerably more work would be

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needed to break down the records by districts, since postal addresses do not precisely match local government boundaries at this level. It would not be possible at present to reflect local variations in the rate of duty.

9. However, with the new computers due to be installed, and a simple question on licence application forms, DVLC will be able to offer allocation precisely, as stated by individual motorists, according to counties or districts in which cars were reported to be registered and be able to pick up in the allocation local variations in the rates of duty. This new, full system would be possible from 1988. The distribution would be made by reference to records held by DVLC so there would be no need to limit the present freedom of choice about where and how VED is paid.

10. There could be problems when a registered keeper moves house and when a car is sold. These would be greatly multiplied if the duty were levied at the district level. Adjustments of duty paid to reflect movement to an area with a lower (or higher) rate of duty would be too complicated to administer; the duty would have to be paid for a fixed period on the basis of the rate of duty relevant at the time of payment. If as a result more people chose to take out 6 month licences there would be a considerable increase in handling costs by the Post Office and staffing at DVLC. It would be important that the register was kept up-to-date, especially by registered keepers notifying changes of address, and it might be necessary to strengthen the powers requiring keepers to do this. There would nonetheless be some who chose not to notify their moves to higher duty areas but, if other pressures (see paragraph 5) led to relatively small variations in levels of duty, the problem should not be too serious. General enforcement measures would help ensure that at least some level of duty had been paid.

E SUITABILITY AS A LOCAL TAX

11. Ministers would need to consider whether the public acceptability of VED as a local tax would require it to be linked to the services which local authorities provide for motorists. Overall, motorists pay in taxation about $2\frac{1}{2}$ times their road costs. Fuel duty is generally accepted as a means of raising revenue, but VED is still widely seen as the successor to the 'road fund licence'. There could therefore be considerable objections to handing it over to local authorities and allowing them to increase it in order to fund their general expenditure,

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particularly if it were given to district councils, which do not have any direct highway responsibilities. The feasibility of introducing a local VED therefore depends on an assessment of the strength of these objections.

F BUOYANCY OF VED

12. Because VED is charged as a specific duty, the yield does not increase automatically in line with changes in prices or incomes. However, VED is no less buoyant than local authority rates.

G PERCEPTIBILITY AND ACCOUNTABILITY

13. A local duty would be quite perceptible, but this would increase the pressure on owners to register vehicles in low taxed areas which would weaken accountability. Although about 30 per cent of cars, and most light vans, are operated by businesses there is no reason for excluding such vehicles from a local duty since businesses will benefit from any general action to limit local authority rates.

H COSTS OF ADMINISTRATION

14. It is estimated that the current annual cost of collecting and enforcing VED is about £50 million. The lion's share of this relates to the cost of collecting VED on cars. If a local duty were introduced it would be appropriate to ensure that DVLC's costs were fully recovered from local authorities. (The cost of maintaining the central register would continue to be borne by DVLC.)

LOCAL EXCISE DUTIES ON TOBACCO PRODUCTS OR ALCOHOLIC DRINKS

1. The Group considered whether the possibility of a local excise duty on road fuel discussed in Annex K could be extended to cover tobacco products or alcoholic drinks. This Annex explains why the Group have decided not to recommend this.

A PRACTICABILITY AND COSTS

2. The formidable problems involved in using either methods (i) and (ii) described in paragraph 7 of Annex K would be equally applicable to tobacco products or alcoholic drinks. At the same time, the control problems involved in collecting tax at the retail stage (method (iii)) would be worse: there are about 150,000 retail outlets for alcoholic drinks and 250,000 for tobacco products. These include many small businesses who already find the requirements of VAT accounting and returns burdensome and difficult. The costs of effective control for the taxing authorities and of compliance for the retail businesses concerned would be very substantial.

B ACCOUNTABILITY, PERCEPTIBILITY AND CROSS-BORDER SHOPPING

3. Local taxes on tobacco products or alcoholic drinks would not be very perceptible, and it is not easy to see how they could be made so. Assuming the national structure were to be followed, there would be at least four rates of duty for different tobacco products and about a dozen for drinks. Notices displaying tax rates on retail premises would therefore be a less practicable solution than for road fuel.

4. Both tobacco products and alcoholic drinks would be the subject of considerable cross-border shopping. Cigarettes might be especially vulnerable since they are of high value but low weight. Although a strong incidence of cross-border shopping might create pressures for convergence of tax rates over time, it would also lead to an inevitable lack of local accountability in the short term. The tax yield for individual local authorities would also be unpredictable.

C FAIRNESS

5. Tobacco products and alcoholic drinks are almost entirely purchased by consumers. The duty on tobacco is regressive and that on beer mildly regressive. On the other hand, the duties on wines and spirits are progressive measured against expenditure. In terms of equity between individuals local duties on tobacco and drinks would, of course, discriminate in favour of non-smokers and tee-totalers. This would exacerbate the effects of the existing national duties, but the reinforced element of selectivity might attract particular adverse comment if they were to become new sources of local authority income. The indirect effects which would feed through in the case of road fuel duty on businesses purchases would not be present here.

D TAXABLE CAPACITY

6. In general, tobacco products and alcoholic drinks are already highly taxed. The weight of tax is particularly high on cigarettes and in the off-licence and supermarket price of whisky, accounting for about three-quarters of the price in each case. The scope for local taxation as an addition to the national duties is further constrained by the substantial losses in output and employment which the tobacco and drinks industries (with the exception of wine, which is largely imported) have already suffered as a result of the recession.

7. In the Group's view it would be well-nigh impossible to match the potential yield of a local excise duty on road fuel from tobacco products or alcoholic drinks, used either singly or together. The table below illustrates a package designed to yield close to £2,000 million to local government, but the sensitivity of demand to price for most items (combined with the high weight of tax in price) would result in substantial effects on national taxation revenue, and in political and industrial terms the rates of duty illustrated might well be judged intolerably high. The estimates (which are however subject to substantial margins of error for such large changes) are as follows:-

CONFIDENTIAL

| | Level of local duty | VAT- inclusive price change | Revenue to local authorities £m | Net loss to Exchequer £m |
|---------|------------------------------|--------------------------------------|--|---------------------------------------|
| Tobacco | 20p(1) | 23p | 1,000 | - 300 |
| Beer | 5p(2) | 5.75p | 550 | - 25 |
| Wine | 20p(3) | 23p | 150 | - 40 |
| Spirits | 100p | 115p | 250 | - 160 |
| | | | <u>£1,950m</u> | <u>£525m</u> |

(Notes: (1) Packet of 20 cigarettes; (2) typical pint at 1037°; (3) table wine. Consequential increases pro-rata for other products.)

E COMPATIBILITY WITH THE GOVERNMENT'S FISCAL STRATEGY

8. Like the duty on road fuel, the duties on alcoholic drinks and tobacco products are important sources of central government revenue. As noted in paragraph 7 above, the imposition of local duties would have considerable implications for central government by reducing overall demand and, therefore, the national revenue. As in the case of road fuel, local duties would also reduce the scope for any real increases in the level of the national duties and could inhibit the use of the regulator between Budgets to vary central Government income.

F CONCLUSIONS

9. For these reasons the Group concluded that the approach of the 1981 Green Paper in rejecting local duties on tobacco products and alcoholic drinks remains valid and should be reaffirmed.

CC MASTER



file

HLP
cc Mount 2
Gregson's

10 DOWNING STREET

From the Private Secretary

13 April 1983

Dear David,

LOCAL GOVERNMENT FINANCE

The Prime Minister held an informal meeting this afternoon to discuss reform of the rates. Apart from your Secretary of State, the Chief Secretary, the Chancellor of the Duchy of Lancaster, the Minister of State for Local Government and Environmental Services, Mr. Wolfson and Mr. Mount were also present.

The Prime Minister recalled her commitment at the Institute of Directors Conference in the Albert Hall in February to bring forward a package on reform of the rates before the General Election. She knew that your Secretary of State and his team of officials were working hard to produce a paper for the next meeting of E(LF) on this subject, but she thought it useful to take stock of the position, in particular given the imminence of the local elections and the likely pressure which they would generate for some further statement of the Government's policy. Your Secretary of State mentioned that in the work which was going on he was envisaging either a freeze on rate increases (and perhaps a freeze of varying severity for domestic and non-domestic rate increases), or alternatively, a limitation on such increases; he was also contemplating some version of the referendum scheme which had earlier been put forward but not proceeded with and a number of alternative taxes which might form a safety valve in a rates freeze or limitation. But there were a number of complex problems on which they were working - for example, possible European objections, and the difficulties which the Treasury had seen in alternative taxes. He recalled that the Prime Minister and he had been told that it would not be possible to secure Parliamentary support for a local sales tax.

There followed some discussion of the possibility of limiting rate increases to an appropriate measure of the rate of inflation (probably not the RPI), or to a somewhat lower level, with a poll tax for high spending authorities. If the permitted rate increases were set too low, there would be an unmanageable number of applications for derogation, and the Secretary of State might find himself in an impossibly large number of legal actions opened by hostile local authorities. Another possibility for a safety valve would be to require high spending local authorities to sell their assets (many had excess land holdings, for example) or to run down their reserves. Alternatively,

/the Government

the Government might be prepared to allow a somewhat higher rate increase than the norm on certain conditions; for example, a value for money audit might be insisted upon. The aim of all this would be to mobilise public opinion against the high spenders.

Summing up the discussion, the Prime Minister said the Secretary of State should go ahead with the preparation of his E(LF) papers, taking account of the points raised in this discussion. There would be merit in considering again the recommendation of MISC 79 for a rates concession for single occupancy properties. She recognised, however, that there were arguments for and against this proposal.

I am sending a copy of this letter to John Gieve (Chief Secretary's Office). I would be grateful if you and he could ensure that it is not photocopied or distributed outside your Private Office.

Yours sincerely,

Michael Scholar

D.A. Edmonds, Esq.,
Department of the Environment.

PRIME MINISTER

RATES

You are seeing Tom King tomorrow afternoon about local authority expenditure and rates. I have had a word with David Wolfson about this.

As you know, Tom King and Terry ^{ei}Hyser have been working flat out to produce a paper for E(LF), on the scheme discussed at the last meeting of the group. I understand that all leave has been cancelled for the people concerned in the DOE, that they have been working over weekends and so on. The meeting is scheduled for the end of this month. Tomorrow's meeting is, therefore, premature so far as reaching conclusions about capping the rates etc. are concerned: all Tom King can really say tomorrow is that he will be in a position at the end of the month, but not now, to say what our policy on rates should be. But David Wolfson is keen that you should have this meeting, so as to agree a line for the local elections - and perhaps also for the General Election, whenever it is, since it may be that the E(LF) will not be far enough advanced to permit inclusion of a specific policy on rates in the manifesto. But, as things stand, the Environment team are working as hard as they can to produce a scheme in time for the manifesto. I think that you should make it clear at tomorrow's meeting whether or not you want them to go ahead with their efforts to this end.

Ferdy Mount would like to come to this meeting, as he has been doing a good deal of work with Terry ^{ei}Hyser and co. May he, too, attend?

MCS

12 April 1983



Memo

2 Marsham Street London SW1P 3EB

01-212 4394

Local Govt

To see (I don't

Department of the Environment
From the Deputy Secretary,
Terry Heiser
Finance and Local Government

*know why he
bothered).*

COPY NO 1.

PERSONAL & CONFIDENTIAL

Michael Scholar Esq
Private Secretary
No 10 Downing Street
London SW1

MUS 1/3

28 February 1983

LOCAL TAXATION

You asked me in effect whether we could move faster to an E(LF) inter-departmental report than the end of March.

I explained that we could not because although we have a number of building blocks available, the interim and final schemes we have been asked to examine contain major new elements eg :

(i) Interim scheme. The concept of take-out of teachers' pay linked to an interim control of rate increase scheme is new. The "Chief Secretary" scheme of rate increase control was never worked out in detail because at an early stage it was rejected in principle by the majority of MISC 79.

(ii) Final scheme. The concept of a ceiling on rate increase linked to a supplementary expenditure tax (LST or excise duties) and perhaps control is new. There was a preliminary discussion of LST and excise duties in the Green Paper as main taxes, but no detailed work was carried out on them subsequently because again at an early stage MISC 79 rejected these taxes as main taxes - the idea of using them as a supplementary tax did not emerge until Cabinet took the MISC 79 report.

/So

So we have a great deal of new work to carry out - so much so that an end March timetable means that we must work flat out - we have already produced six papers and held two meetings of the inter-departmental group - and concentrate on the main issues, and not allow ourselves to be diverted by secondary problems.

I 'll be in touch with Ferdy Mount about a meeting to bring him up to date with progress.

I am copying this letter to Michael Buckley.

Yours
T M Heiser

T M HEISER

PRIME MINISTER

Prime Minister

LOCAL TAXATION

MS 15/2

The Disadvantages of Rates

It is tempting to cling to the hope that, in an era of lower inflation, the objections to the present rating system will die down. Outside the Metropolitan Councils, it is said, the savage, unpredictable rises of the past five years will in future devastate fewer household budgets.

This is highly dubious. It would be dangerous complacency to imagine either that the unpopularity of the rates is fading or that the shortcomings of the recent situation have miraculously disappeared. On the contrary, it is more likely that quite soon the rating system as it now is will finally collapse.

(a) At present levels, rates offer very poor accountability because so many people cannot afford to pay and have to be given rebates. "Representation without Taxation" on such a scale is a continuing scandal.

(b) So is "Taxation without representation", from which industry and commerce suffer. Rates constitute the worst single unavoidable tax on business - and one which rises inexorably, quite regardless of a firm's ability to pay.

(c) The functions of local government have grown far beyond the ability of the rates to finance them. As a cheap-to-collect, inelastic but highly visible property tax, the rating system worked well enough when it had only to pay for the modest assortment of functions which local councils carried out before the war. It cannot and should not be expected to finance half the welfare state.

(d) Even if rates only increased at five per cent a year from now on, they would still double in 14 years - another huge tax on commerce and a further bewildering blow to householders on fixed incomes.

Tom King's Scheme

The first advantage of the new scheme is that it sets out to deal with the historical reality. Unlike previous efforts, it does not sweep away the ancient system of property taxation.

It offers instead a supplementary tax which, like most expenditure taxes, is related to the ability to pay - thus beginning to remedy the most obvious defect of the rates.

As rates came to take up a smaller proportion of the family budget, fewer people would need rebates and accountability would be increased.

Local Sales Tax

The virtues of a VAT-based Local Sales Tax are

- (i) it is indirect, and does not affect incentives;
- (ii) it produces a high and buoyant yield;
- (iii) it is based on an existing tax.

No other supplementary tax combines these advantages.

The fact that LST received negligible support in public consultations on the Green Paper may say more about the consultations than about public feeling. Those official lobbies which opted for a replacement for the rates tended to opt for local income tax, but income tax deductions are far more unpopular than VAT, and rates are more unpopular than either.

The disadvantages of LST are discussed in paragraphs 10-13 (I follow Tom King's numbering).

10-11. Precepting poses a problem of accountability already under the existing system. But so long as all the tiers are composed of elected representatives, the problem is no worse with LST.

Cross-boundary shopping, by contrast, may well increase the pressure of accountability. Shoppers will be attracted by towns which have a low LST rate or none at all.

B.R.

Revenue yields from LST and rates combined will doubtless bear no closer relation to a local authority's needs (whether measured by GRE or any other assessment) than rate revenue alone bears at present. That is what RSG is for.

12. To keep LST rates stable and to avoid making LST excessively complex, there is a case for allowing rates to fluctuate below the ceiling.

Interim Scheme

18. If we want to capture the prize of putting a ceiling on the rates now, then we have inevitably to control rates in the interim until LST can be introduced.

The problems of control are considerable. The one which unhorsed the Chief Secretary in MISC 79 was the necessity to give the S of S for the Environment an override over his colleagues. But even this would be tolerable because it would be temporary.

19. We must base the ceiling on 1 April 1983. If we then announce our scheme at any time after 2 April 1983, we shall block off most possibilities of mischievous upratings. For the subsequent 2/3 years of interim control, we should offer only austere provision for inflation.

Exchequer Funding of Teachers' Pay

20-23. Transfer of teachers' pay to the Exchequer certainly would not be worthwhile for the interim period alone. Its purpose is long-term: to reduce the scope of functions which are to be financed, in whole or part, by locally raised revenue, and so to reduce the "gearing" which has enabled Councils like Camden to raise such vast sums from their ratepayers.

The transfer cannot be effected without spending control, to prevent diversion of money saved to other services. It ought therefore to be effected during the interim period of expenditure control.

24. No interim?

The option of dispensing with the interim control period and pressing on with the earliest possible introduction of the long-term scheme (April 1987 at the earliest) has serious disadvantages.

- (i) We should lose the prize of offering a "Rates Ceiling Now".
- (ii) Spendthrift authorities would have four more years to milk their ratepayers.

It is doubtful whether the upheaval of change would be worthwhile without those advantages.

The Long Term

After the change - towards the end of the next, Parliament - we would be able to show the people:

- (i) Local property taxes which were stable and predictable. When you bought a house, you would know just what you were taking on.
- (ii) A supplementary Local Sales Tax which would provide a source of revenue that would increase with inflation and national wealth. Thrifty authorities would be rewarded by attracting industry and commerce.
- (iii) A system of local revenue and expenditure which was more limited in extent. The thirty-year-long tendency of Governments to thrust more and more services into the lap of usually incompetent and occasionally malign local authorities would be brought to a halt. On the one hand, we would privatise and contract out. On the other hand, the State would take specific responsibility for half the schools budget - which is only fitting in "a national system locally administered".

We would have stopped what Arthur Seldon calls "municipal imperialism" dead in its tracks.



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P.0965

PRIME MINISTER

Local Taxation
(E(LF)(83)2 and 3)

BACKGROUND

At their meeting on 20 January, the Cabinet decided that the recommendations in the report of the Ministerial Group on Local Government Organisation and Finance (MISC 79) for reform of the domestic rating system were an inadequate response to the needs of the situation (CC(83)1st Conclusions, Minute 7). You said that you would arrange for the issues to be considered further; the Ministerial Sub-Committee on Local Government Finance, of which this is the first meeting, has been set up for the purpose.

2. The broad thrust of the discussion of local rates on 20 January was as follows:

a. Local rates could probably not be abolished, certainly in the short term, and perhaps indefinitely.

b. It was, however, necessary to limit their burden.

c. This would entail one or more of: giving local authorities additional sources of revenue; relieving local authorities of some of their statutory obligations; and taking more responsibility to central government, whether by transferring responsibility for some local authority services or by the central Government's defraying a larger proportion of local authority expenditure. There might also need to be more central control of expenditure by individual authorities.

3. The memorandum by the Secretary of State for the Environment (E(LF)(83)2) concentrates on changes in the way in which local authorities



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raise their revenue. For the longer term it proposes a ceiling on rate poundages; local authorities would be able to raise additional revenue by levying a local sales tax (LST). It is not clear from the memorandum whether all local authorities down to district level would have this ability, or whether it would be confined to upper-tier authorities (essentially, the counties) as suggested in the Green Paper "Alternatives to Domestic Rates" published in December 1981.

4. A LST could not be effective before April 1987 at earliest (this is the date suggested in the Green Paper: since then, time has passed; and April 1988 may be a more realistic estimate). If the rates freeze is to have immediate effect it will be necessary to devise an interim scheme to cover the intervening period. The memorandum proposes an arrangement under which central Government would make good the whole of any gap between rate income (plus fees and other minor items) and an approved level of expenditure. In principle, this means setting an approved level of expenditure for around 500 local authorities in Great Britain. That would be a formidable task: MISC 79 concluded that even a more limited scheme, designed to bite on only 20 or 30 high-spending authorities in England, raised too many problems to be desirable. Paragraph 24 of E(LF)(83)2 therefore hints at an alternative of not limiting rates until the LST can be brought into effect.

5. In E(LF)(83)3 the CPRS argue that the proposal to use LST, which is less visible and painful than rates, to finance marginal increases in local authority expenditure may run counter to the Government's objective of reducing local government spending; that controlling local authority expenditure would be a severe diminution of local government autonomy; and that the right course might be to use LST to finance part of local authority expenditure but to use domestic rates to finance the increase.

MAIN ISSUES

6. You will clearly not want the Sub-Committee to get into too much detail at this stage. The main issue is to judge whether a scheme broadly on the lines put forward by the Secretary of State for the Environment meets



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the Government's policy objectives and is likely to be politically attractive.
The discussion might then focus on some of the more important specific
issues as a basis for future work, ie:

- what if any control of local authority expenditure should be envisaged and how permanent should it be?
- should the Exchequer take responsibility for funding some local authority expenditure (eg teachers' pay)?
- should all categories of local authority have access to LST? should tax rates be set only on a county basis? how do the proposals fit in with the Government's provisional intention to abolish the metropolitan counties?

Broad judgement about the proposals

7. The main advantage of the Secretary of State's proposals is that they would permit the Government to say that it will impose a ceiling on rates which are an unpopular tax. The main disadvantages are:

- a. the introduction of a new tax;
- b. the fact that the particular tax chosen, LST, will tend to increase prices (albeit marginally over a wide range of goods and services) and will inhibit the Government's ability to draw revenue from VAT;
- c. the risk that the new tax will encourage more local government spending;
- d. the difficulty that the new tax is unlikely to be introduced before 1988;
- e. the need either to postpone the ceiling on rates until 1988 or to introduce before then a scheme for giving more financial help to local authorities with a tight control of local authority expenditure.

8. The Sub-Committee will want to consider the broad balance of advantage and disadvantage. Both the Chief Secretary, Treasury and the CPRS are likely to express concern that introduction of a new source of local authority revenue (especially of a less perceptible kind) may merely add to local government spending and that the more important objective should be to control the latter. This may lead the Chief Secretary to argue for a permanent control on local authority expenditure either as a substitute for the introduction of LST or as a supplement to it. The arguments about the resulting loss of local autonomy are well known. This leads the CPRS to argue for using LST to take the first slice of local authority spending and for keeping the rates to finance the increase. The difficulty with the latter proposition is that it would not avoid regular rate increases; arguably rate increases would still be unpopular even from a lower base.

9. If the Sub-Committee feels that it wants to bring rate levels down without the odium of introducing a new tax, one way of doing this would be to transfer responsibility for financing some part of local government expenditure (eg some or all of education) to central Government. This would have to be combined with some means of restricting local government rating powers or expenditure. Such a proposal would raise very difficult issues about the relationship between central and local government, but it may be argued that these issues arise also on the Secretary of State's proposals.

Control of local authority expenditure

10. If the Sub-Committee decides that control of local authority expenditure should be a feature of the proposals, either for an interim period until a new source of revenue is introduced, or more permanently, the form of such a control will need to be considered carefully. The scheme outlined in paragraphs 18 and 19 of the Secretary of State's paper would appear to involve detailed scrutiny of the budget of all local authorities. It must be doubtful whether this would be practicable, even for an interim period. An alternative would be to try and devise a system of control of only the highest-spending authorities, such as that advocated by the Chief Secretary in the MISC 79 discussions, but further examination would be needed to establish its feasibility.



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Exchequer funding of local authority expenditure

11. If the Sub-Committee takes the view that one element in the proposals should be Exchequer funding of some part of existing local authority expenditure, the possibilities will need to be examined. The options discussed in the paper include teachers' pay, the whole of the education budget, or the police service (already supported by a 50 per cent specific grant). All raise some difficult issues of general policy.

Access to LST

12. If LST is to be an element in the proposals the Sub-Committee will need to take a view on whether it should be available to all tiers of local government or only (as the Green Paper suggested) to the upper tier. Unless LST is available to all local authorities, the rates ceiling cannot apply to all of them. If however the rate of LST varied at the district level, the costs of administration would be high. Moreover, particularly in metropolitan districts, there would be extensive cross-border shopping and this would eventually be a source of much friction and controversy, not least from those who could not engage in it, such as the immobile.

13. The alternative would be to have the rate of LST fixed at the county level, allowing all local authorities to have access to it. The problem is that there would be a loss of accountability; an extravagant district could impose costs on the inhabitants of another district in the same county. Moreover there is a particular difficulty arising from the provisional intention to abolish the metropolitan counties. It could be argued that it would be wrong to allow the joint boards or committees running the services at the county level in metropolitan areas to set the rate of LST since they would not be directly elected.

Timetable

14. Paragraph 24 of E(LF)(83)2 suggests that officials should be instructed to put forward more developed schemes for consideration by the Sub-Committee



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no later than the end of March. The feasibility of this timetable will depend on how far the Sub-Committee can reach a clear view on what the main elements of the proposals should be. It may be useful for the Sub-Committee to reach some preliminary view on what the nature and timing of the end-product should be. Is the aim to have a Green Paper and, if so, when?

HANDLING

15. You will wish to ask the Secretary of State for the Environment to introduce his paper and then to invite comment from the Chief Secretary, Treasury. All members of the Sub-Committee are likely to want to contribute. You may wish to give Mr Sparrow the opportunity to enlarge on the CPRS paper.

CONCLUSIONS

16. You will wish the Sub-Committee to reach conclusions on the following:
- i. should there be a ceiling on rates, combined with the introduction of local sales tax (LST) as a supplementary source of revenue for local government?
 - ii. should this be combined with a control on local authority expenditure, either in the interim before LST is introduced, or permanently?
 - iii. should there be Exchequer funding of some existing element of local authority expenditure and, if so, which element?
 - iv. if LST is to be introduced, should it be available to all local authorities or only the upper tier? should there be different rates at district level, or only at county level?

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v. what further work should be put in hand, within what timetable?

vi. should the aim be to produce a Green Paper and, if so, when?

PLG

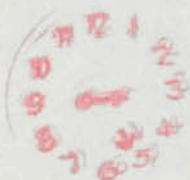
P L GREGSON

15 February 1983

CONFIDENTIAL

CONDUCTOR

15 JAN 1963



cc jr

PRIME MINISTER

SUB COMMITTEE ON LOCAL GOVERNMENT FINANCE

I have seen the Environment Secretary's paper E(LF)(83)2. Although the introduction of a new tax would be complicated and politically unattractive, I do not dissent from his proposal that officials should study further the details of a local sales tax (LST).

But I think it right to make two points at this stage. I am strongly opposed to his interim proposal to set a ceiling on rates, close the gap between income and expenditure by Exchequer grant and, as a corollary, set expenditure limits for all local authorities. The objections to this summarised at the end of paragraph 18 of his paper seem to me decisive.

I am equally opposed to the suggestion that the whole cost of teachers' salaries should be met by the Exchequer. The scheme of control mentioned in paragraph 21 would require me to determine each local education authority's complement of teachers. This would draw me into local decisions about the deployment of teachers between schools; impede efficient management of the education service as a whole; and require a substantial increase in the number of civil servants.

I am sending copies of this minute to the other members of E(LF) and to Sir Robert Armstrong.

KJ

15 FEBRUARY 1983

Local Govt,
Rating System
A2



15 JAN 1983

PR
 Prime Minister

The top copy of this has
 never reached us.

PRIME MINISTER

SUB COMMITTEE ON LOCAL GOVERNMENT FINANCE

MCS 16/2

with me

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I am sending copies of this minute to the other members of E(LF) and to Sir Robert Armstrong.

KJ

15 FEBRUARY 1983

Local Govt
Pth

PRIME MINISTER

①

The Education Secretary and the Industry Secretary have asked if they can be members of your Small Working Group on Rates. The whole idea behind the Small Group (whose membership is Home Secretary, Scottish Secretary, Environment Secretary, Chief Secretary, and Chancellor of the Duchy) was to avoid the situation in Misc 79 where all the interested Departments were represented, and where, consequently, it proved difficult to reach a conclusion which was something other than the lowest common factor.

Agree to keep E(LF) as it is?

Yes - at full-
- - no

MCS

TOW RTA office
MCS 15/2

if you let Education and Industry in the others who will want to come

might be: DHS-S
Transport
Lord President

14 February, 1983.

SECRET

This copy filed on LOCAL GOVT : Relations Pt 15. |

MR. MOUNT

cc: Mr. Butler ✓

LOCAL GOVERNMENT EXPENDITURE AND RATES REFORM

This note records in outline a discussion which the Prime Minister had this afternoon, with the Secretary of State for the Environment, about local government expenditure and rates reform. You and I and Robin Butler were also present.

The Prime Minister said that there would be a great political prize in a decision that there would be no further increases in rates. It would be best not to describe this as "freezing" the rates, since such a description would suggest that rates would remain at their existing levels - higher in some places and lower in others - in perpetuity. This would be manifestly unjust; and undesirable. What was required, rather, was a ceiling upon rates, either at their present level, or on whatever levels they were at when the ceiling was announced. The hope would be that local authorities would reduce their rates under this ceiling. There was a case for providing that, once reduced, rates could not again be raised. On the other hand, this might lead local authorities never to reduce their rates.

The imposition of such a ceiling would need to be accompanied by a number of other measures. After their rates were frozen in this way, local authorities would either require a new source of finance to bridge the gap between their rate revenue and their inescapable cost increases; or there would have to be a re-distribution of functions between central and local government. On the first of these possibilities, there could be, in effect, a new tax. This would best be a tax on expenditure, and since any new form of taxation was ruled out as politically unacceptable, this pointed to a local VAT. Alternatively, there could be an increase in Rate Support Grant payments, or, where the local authority concerned received no RSG, some form of supplementary grant.

/Another

SECRET

- 2 -

Another possibility would be to increase the grant paid to the Police, say, to 75 per cent or for central Government to take over the pay of teachers' salaries. These latter possibilities led into the alternative general solution, canvassed above, of shifting the border-line of responsibilities between central and local government.

The Prime Minister asked you to discuss these issues with Mr. Heiser at the Department of the Environment, in order to assist the preparation of Mr. King's paper for the Prime Minister's small Group of Local Government Expenditure and Rates next week. The aim would be to circulate a paper as soon as possible, so as to allow time for the other Ministers concerned to put forward their own views.

7 February 1983

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Prime Minister

CJV

Tom King asked to come in
for a private word with you on

Prime Minister



Monday about 4 February 1983

all this (at 4 p.m.) M/S 4/2

I understand we are to meet on Monday to discuss the rating problem in advance of E(LF). I think it might be helpful if I set out key issues that I believe are relevant to our further work.

There are 3 main considerations:

- i. the political need to meet the expectations of the Party and the country on rating reform;
(This obviously includes issues of fairness and avoidance of undue burden of a property based tax as regards both domestic and non-domestic sectors)
- ii. degree of local accountability to preserve public perception of councillors responsible for expenditure decisions;
- iii. whether it tends to increase or decrease overall expenditure levels.

The main work that we have done in Misc 79 was to see whether we could agree on an available source of revenue as alternative to rates. This was not possible and the alternative suggestion was then made of a discount for the single person.

Your approach opens a different avenue with the proposal of a freeze on rates supplemented by an additional source of revenue only to meet cash increases in expenditure over the years. This obviously changes all the figures and will have the effect of progressively diminishing the significance of the property based rates.

If we take this course, we should obviously seek to freeze rates at the existing level, to give authorities a supplementary tax as quickly as possible, and to seek to ensure that the supplementary tax maintains the disincentive to high spending. On the crucial question of timing it seems inevitable that there will be an interim period before the supplementary tax can be introduced during which some interim measure will have to operate. I refer to that later in this minute.

First, the freeze. The most difficult question is that some people would be frozen at higher levels than others. This is unfortunate and it would be possible to adjust in some way. However, this would raise other problems, and my own view is that the right political imperative must be a straight cash freeze at levels operating when announced.

The second question is which supplementary tax. I believe we must reject local income tax, local pay-roll tax, local corporation tax, local duties on cars, fuel, tobacco etc. That leaves 2 other possibilities, albeit extremely difficult, local sales tax or poll tax.

Poll tax is very perceptible, reasonably predictable, direct tax, relatively quick to introduce, suitable for all tiers (precepting and rating tiers). Problems are the register from which it operates with the reluctance of colleagues to see the electoral register used for this, and the difficulty of enforcement. Timetable - legislation summer 1984 for earliest introduction April 1986. Poll tax was, incidentally, the one that attracted considerable interest among back bench colleagues during our consultations, very much

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on the basis as envisaged here, as a propping up tax and not as a full replacement. Poll tax would however only affect the domestic sector. This raises the question of whether you have a supplementary tax for non-domestic as well or accept a different balance between the contributions of the domestic and industrial/commercial sectors in the future.

Local Sales Tax (LST) is an indirect tax; has a high yield. Could fall on the non-domestic as well as the domestic sector. The disadvantages are that it is unpredictable; lumpy, unpopular with traders. The Green Paper said that it was unsuitable for the lower tier because of administrative costs, cross-border shopping etc; and the problem could be worse if the GLC and metropolitan counties were abolished.

LST coverage should be same as VAT coverage. Introduction depends on VAT computerisation. Introduction April 1987 may be possible - implies enactment by summer 1986.

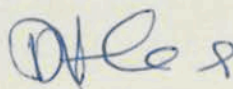
This suggests a freeze plus supplementary tax might be feasible from 1 April 1986 with poll tax alone; from 1 April 1987 with poll tax and/or LST.

With the dates of 1 April 1986 or 1 April 1987 as possible starting dates for the introduction of a supplementary tax, there is clearly a need for some interim measure if a freeze is to be operated from an earlier date. One way to operate freeze without supplementary tax might be by increased Exchequer support. There are two possible ways to increase Exchequer support a) increase RSG; b) take over teachers pay.

RSG could be increased with effect from April 1984. Take over of teachers pay would involve DES approving teachers numbers; this could not be introduced before 1 April 1985 at the earliest. Both these routes could allow a reduction in rates but would leave a clear risk of higher spending unless authorities were made subject to control. Control is very vexed issue but even if we could find a practical and legally defensible method it is unlikely to be available until 1 April 1985.

Selective control of higher spending has already been discussed in Misc 79. All the problems rehearsed would be magnified if all authorities were controlled ie a) legal and local political confrontations; b) the need for more civil servants; c) the time needed for introduction. Control could not be brought into force before 1 April 1985 because legislation introduced by autumn 1983 would be too late to affect 1984/5 because of the inter-action with the RSG settlement; d) the Secretary of State for Environment would need to have an 'override' over other spending Ministers to fix spending levels.

I have dealt, in this minute, only with the bare bones of possible routes of action which I hope will be helpful for our meeting. I do not need to dwell on the many difficulties that lie within them since they will argue for themselves!



AK

TOM KING

(Dictated by the Secretary of State and signed in his absence)

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Local Govt
GC JD



C O N F I D E N T I A L

Prime Minister

②

But he responded to
your comment by proposing
direct controls on over-spending
authorities!

PRIME MINISTER

MH

REFORM OF RATES

MCS 27/9

I have seen your Private Secretary's letter to mine of
13 September about my memorandum MISC 79(82)19.

You will remember that you accepted earlier MISC 79's conclusion
that the alternatives which we had considered to domestic rates
should be discarded (Willie Whitelaw's minute of 18 June to you
and your Private Secretary's reply of 28 June refer). My paper
sets out, in that context, the reforms within the rating system
which I now think are practicable; and I well understand your
reaction to it taken in isolation.

But these reforms are only part of a range of proposals for
local government which need to be judged together. These include
David Howell's Bill on Public Transport Subsidies and the items
which MISC 79 has still to consider - such as abolition of the
GLC and the Metropolitan Counties, and a new scheme for the
selective control of rates by high spending authorities. There
is also the possibility of a vigorous extension of contracting
out in local government services which we are considering in the
context of the review of privatisation and contracting out which
is in hand in response to your personal minute to Geoffrey Howe
of 28 July and his letter to Willie Whitelaw of 11 August.

I hope that you will defer judgement on the rating system
reforms which I have proposed until all these things can be
considered together.

MH

M H

24 September 1982

Local Govt, Relations,
Central / Local
pt 13

Personal and Confidential



Local Govt.

10 DOWNING STREET

From the Private Secretary

13 September 1982

Dear David,

Reform of Rates

The Prime Minister saw over the weekend your Secretary of State's memorandum "Reform of Rates" (MISC 79(82)19).

The Prime Minister has commented that the rates problem is coming into great political prominence once again, especially in London and also with non-domestic ratepayers everywhere. The Prime Minister has further commented that she thinks the proposals in your Secretary of State's paper are totally inadequate to deal with the problem.

Yours sincerely,

Michael Scholar

David Edmonds Esq
Department of the Environment

ACTION

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MCS

Prime Minister ②

MCS 1074

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MISC 79 (82)19 COPY NO **1**

10 September 1982

The RATES problem

CABINET *is coming into prominence*

MINISTERIAL GROUP ON LOCAL GOVERNMENT ORGANISATION AND FINANCE

is required - especially in

REFORM OF RATES *London and also with some domestic*

Memorandum by the Secretary of State for the Environment

_____ *rate payers everywhere*

(I think these proposals are totally inadequate to deal with the situation)

INTRODUCTION

1. At the last meeting of the Group, I was asked:

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- discount for households with a single adult (scheme 1); and
- discount for households with a single adult and for retirement pensioner households (scheme 2).

It also analyses three further schemes which would operate on more restricted definitions of liability:

- discount for single retirement pensioners (scheme 3);
- discount for single retirement pensioners plus pensioner couples (scheme 4); and
- discount for single adults and couples in receipt of a wider range of state pensions (scheme 5).

Flat-Rate Discounts

3. A flat-rate discount would be more effective than a percentage discount in concentrating resources where they were most needed among those ratepayers who qualified, since it would give the greatest proportional benefit to people on lower incomes.

4. The cost of a flat-rate discount, unlike that of a percentage discount, would not increase automatically with the increases in rate bills: we should therefore have to provide for periodic uprating of the discount level if we wished to present flat-rate

PART 1 **ends:-**

MCS to CPRS 28.6.82

PART 2 **begins:-**

Misc 79(82)13 23.7.82

