

PRIME MINISTER

1 August 1985

REFORM OF LOCAL AUTHORITY FINANCE
MEETING WITH VICTOR ROTHSCHILD

William Waldegrave's reforms are now being investigated in detail by a large number of inter-departmental official groups. Several hundred pages of complicated prose have been produced, and some interesting points have emerged; but the exercise has mainly been of benefit to the paper manufacturing industry.

At the end of this laborious process, the official result is likely to be a slightly modified version of what you saw in May:

- a 'resident's charge' replacing domestic rates, with rebates for the poor, but with everybody paying something;
- a uniform non-domestic rate, pooled and redistributed by central government;
- a simplified needs grant;
- special targetted aid for the inner cities;
- special arrangements for London;
- transitional arrangements to prevent sudden shifts of the sort seen in Scotland.

Although the worst losers will have been eliminated, there may still be some large swings, with local domestic taxes ranging between, perhaps, £75 and £250 per adult.

A New Domestic Tax

As you know, alongside the grinding efforts of the official machine, rather more interesting and politically sensitive developments have been taking place. Ken Baker, Victor Rothschild, William Waldegrave and the inner core of officials who produced the original proposals have been talking about the possibility of a single domestic tax with two elements:

- size of dwelling (by square feet); and
- number of adults per home.

This might have several advantages:

1. It would make life easier for the poor pensioner couple living in crowded accomodation; they would pay far less than two retired millionaires living in palatial surroundings.
2. Both elements of the tax would be entirely objective: no need for judgements of supposed rental value. (It transpires that the Treasury already keep detailed figures on the size of dwellings, because they need these for domestic rate valuations; there should consequently be no technical problem with the determination of the square footage element.)
3. In the shire counties there could be a straightforward division of the spoils: the dwelling element of the tax could go to the district, and the people element to the shire. This would make good sense, since districts tend to provide property-based services like refuse,

whereas shires tend to provide people-based services like education.

4. As you saw when you met the Conservative leaders of the AMA, ACC and ADC, a mixed tax of this sort might win widespread support in the Party.

Keeping Supporters On-Side

We are also investigating various other moves that might make the reforms more politically acceptable without diminishing the principles of accountability and simplicity. These might include:

- indexing the non-domestic rate instead of nationalising it; non-domestic rate increases might be prevented from rising faster than inflation; this would eliminate many of the nasty distributional effects you saw in May and (unlike a national uniform system) it would leave councils free to reduce their non-domestic rates if they chose - a point that many Conservatives think important;
- a very simple resources grant, to provide a safety-net for councils which had small incomes from non-domestic rates; this, too, could find favour with many Conservatives.

These possibilities have been run through the DoE computer: they would produce domestic tax levels in the range of £120-£190 for each each adult in all authorities except London boroughs, and with a range of only £150-£180 per adult in the vast majority of authorities. As with all other packages, special London arrangements would be needed.

The Rothschild Influence

When you see Victor Rothschild, you may want to concentrate on the possibility of a new mixed domestic tax: he has been extremely helpful in promoting discussion of this promising option, and has persuaded DoE to take it seriously. He will want to be reassured that you think it worth investigating.

You may also wish to raise the question of Local Authority Capital spending and the creation of sensible borrowing controls. There has been some Rothschild interest in this problem - and his banking expertise could be invaluable.

Ol Letw.

OLIVER LETWIN