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PRIME MINISTER

Introducing the Community Charge

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DECISIONS

1. There are two issues for decision:

(ii) To confirm the transitional arrangements for introducing the community charge in England and Wales over a period of up to 10 years as set out in 'Paying for Local Government';

(ii) Whether the existing system of rate rebates should be carried through into the new community charge regime, or whether instead assistance should be provided by a flat-rate addition to basic income support.

2. The rebating issue is the only one that is likely to provoke any argument between colleagues. But you will wish the meeting to reach a clear decision, if at all possible, so that planning for the Scottish Bill can proceed at full steam.

BACKGROUND

3. The Committee decided last autumn that introduction of the new regime for local government finance in one go would be too disruptive on the personal finances of local tax payers, and therefore proposed first that the community charge should be introduced over a transitional period of up to 10 years (although only 3-4 in Scotland), and second that there should be a 'safety net' grant to ensure that in the first year no local authority

would lose from the restructuring of the Exchequer Grant and the proposal to pool non-domestic rates.

4. Since these features would delay the full operation of the community charge discipline, the Environment Secretary has been considering whether it would be possible to go faster than the Green Paper implied. He has now gone full circle. His conclusion is that the initial range of community charges is likely to be too great to make this possible and that the Government should therefore stick to the basis in the Green Paper. He suggests, however, that the options should be kept open since there will be an opportunity to review this decision before the legislation for England and Wales is introduced, taking account both of reactions to the Scottish legislation and the success of rate capping in reducing the expenditure of the most extravagant authorities.

5. The Committee reached its decisions on the transitional period and on the safety net grant after extensive consideration of exemplifications and it seems unlikely that anyone will challenge Mr Ridley's conclusion that those decisions should stand. You may therefore be able to conclude this part of the discussion very quickly.

REBATING THE COMMUNITY CHARGE

6. The main issue therefore is whether the community charge should be rebated for those on low incomes.

The Options

7. The main issues were set out in my minute to Mr Norgrove of 26 September. In brief, the introduction of the community charge provides an opportunity to consider alternative ways of supporting those on low incomes. There are two main options:

(i) to carry across a system of rebates related to the actual community charge bills for low income households (in this event the caseload would fall on local authorities);

(ii) to provide no specific support but instead to increase basic income support by an amount reflecting 80 per cent of the national average community charge (in this event an extra caseload would fall on DHSS).

8. Option (i) was the one used for purposes of exemplification in the Green Paper, and there seems to be a widespread expectation that the Government will adopt this course.

Pros and Cons

9. The main arguments against a rebating system are:

(i) A rebate related to the actual level of the community charge would reduce accountability by shielding electors from the full consequences of authorities' spending decisions;

(ii) There would be a substantial increase in caseload because of the larger number of people paying the local domestic tax. This would reverse some of the benefits of the social security review and put more work on local authorities, almost as soon as it had been reduced (a 'Duke of York' effect);

(iii) If the initial level of the community charge is small - the Green Paper suggested £50 in the first year - the amount collectable from those with an 80 per cent rebate will be only 80 pence per month: the administration costs will make this uneconomic.

10. The main arguments for a rebating system are:

- (i) It provides a more direct answer to the principal criticism of the community charge - that of regressiveness;
- (ii) A flat-rate addition to income support would produce very variable results. In low tax areas like Wales and the North West, some would receive over 100 per cent compensation. In the high tax areas such as Scotland, London and the South East there would be significant under-compensation.
- (iii) Those with incomes just above the income support level would be substantially worse off without a system of tapering support. Work incentives would be reduced;
- (iv) To reverse the implicit presumption in the Green Paper in favour of rebating might well increase opposition and endanger the whole reform.

Exemplifications

11. The annex to Mr Ridley's paper shows in detail the effect of retaining or abolishing rebates. (This annex has not been entirely agreed between officials, and Mr Fowler may seek to criticise it, but I believe that it gives a sufficiently accurate general impression for the Committee to reach conclusions.) The table in paragraph 6 demonstrates that for Great Britain as a whole the number of gainers and losers following the switch to the community charge is not a great deal changed by abolishing rebates, although the percentage of losses of more than £2 per week does rise from 17.2 per cent to 20.4 per cent. In Scotland, however, the number of losers increases from 54.3 per cent to 60.6 per cent if rebating is abolished. (This is because local authority expenditure is higher on average in Scotland than in England and Wales, so any compensation scheme based on the national average community charge leaves the Scots worse off.)

12. The table in paragraph 10 shows the effects on people on low incomes. These are more marked than for the population as a whole. In Scotland the introduction of the community charge with

rebating would result in 11 per cent of low income tax units losing more than 2 per cent of their net income, compared with 27.6 per cent without rebates. 65.2 per cent of all Scottish low income tax units would lose with an unrebated community charge, compared with 51.5 per cent if rebating were continued. The position in Greater London without rebating would be worse: 170,000 low income tax units (20 per cent) would lose more than 5 per cent of their net income, and over half would lose more than 2 per cent of net income. As table 4 (at the end of the annex) illustrates, a pensioner couple in Kensington and Chelsea relying on income support would lose 10.4 per cent of their current income through the introduction of the community charge without rebates compared with 3.8 per cent if rebating continued.

13. In summary, the main conclusions which emerge are that the introduction of flat-rate income support rather than rebating would:

- over compensate those living in low community charge areas and under compensate those in areas of high tax bills (with Scotland and Greater London particularly badly affected);
- cause a substantially greater number of large losers (though fewer losers overall), particularly among low income households;
- reduce the caseload on local authorities, but add to that on DHSS.

14. As Mr Ridley argues in paragraph 16 of his paper, in real life the detailed changes shown in his exemplifications will be masked by the long transitional period. The numbers themselves, even if further refined, are also necessarily very by and large, based on a number of uncertain assumptions, and should be regarded as little more than indicators of the direction of change. It may be tempting, therefore, to argue on that account

that nothing would be lost by moving to a flat rate support scheme. Against that, however, the detailed analysis to which both the Social Security Reform and the Local Government Finance Review were subjected suggests that the Government's critics, particularly the poverty lobbies, will judge the proposals on their estimated end result, however academic that might be. This would be the more so if the Government departed from the rebating assumption underlying the examples in the Local Government Green Paper. Moreover, the changes in Scotland will take place sooner, so that the effects on personal incomes will more quickly be perceived. The Government would, therefore, need to be able to deploy a very strong case indeed to justify departing from the rebating assumption.

15. For reasons on the lines of those above the Environment Secretary recommends that rebating should continue. In this he is strongly supported by the Secretaries of State for Wales and Scotland; the latter has made it clear that he thinks it will be politically impossible to carry his Bill through in Scotland on any other basis. The Treasury on balance seem to prefer rebating too; there is little in it in overall cost, but they are very concerned about the threat which abolishing rebating could pose to the whole community charge reform. The Social Services Secretary, however, is likely to continue to argue against rebating.

Presentation of Policy

16. As noted above, the immediate need for a decision stems from the position in Scotland. If rebates are to be provided, the urgency is a little less. The Scottish Bill, which will need to contain an enabling clause, is not due to be introduced until early December. But if there are to be no rebates, this will become apparent as soon as the Bill is published, and, in view of the general expectation of rebates, the Scottish Secretary might be well advised to start signalling the change in intention well before then. It would be difficult to do this before 31 October,

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the closing date for consultation on England and Wales, but it may be hard to avoid saying something in the debate on the Queen's Speech in early November.

HANDLING

17. You will wish to invite the Environment Secretary to introduce his paper. The Social Services Secretary will wish to respond. The Chief Secretary, the Territorial Secretaries of State, and other Ministers will wish to contribute.



J B UNWIN

1 October 1986
Cabinet Office



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