

Subject cc Master

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10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

2 July 1987

Dear Robin,

REFORM OF LOCAL AUTHORITY FINANCE

The Prime Minister this morning held a short meeting after E(LF) to consider how best to present the Government's case on the reform of local authority finance. There were present the Lord President, the Chancellor of the Exchequer, your Secretary of State, Secretary of State for Education and Science, the Minister of State (Department of the Environment), the Chief Whip, Professor Brian Griffiths (No.10 Policy Unit) and Mr. Bernard Ingham.

The Prime Minister stressed the need for the Government to put across the case for the reform of local authority finance more effectively. A true comparison was not between the existing system and the community charge, but between the system with a revaluation and the community charge. The example set by Scotland, and the controversies surrounding revaluations in the 1960s and early 1970s ought to be pointed out to those who were arguing against the new system. There was a need to marshal all the facts. It would be important in particular to prevent Conservative MPs from committing themselves during the Recess to opposing the reforms.

Your Secretary of State described the efforts which were already being made with Conservative MPs and through Conservative Central Office. A unit had been established in the DOE to deal swiftly with correspondence from MPs.

After discussion it was agreed that the Department of the Environment should establish a small unit to handle the campaign to put across the Government's case for the changes. The Prime Minister's Chief Press Secretary, Mr. Bernard Ingham, should have an input to this. Government supporters both in the House and outside it who would be prepared to speak out strongly in favour of the changes should be identified and encouraged to speak as appropriate in the House, to appear on local and national television and radio and to write articles and letters. All Cabinet colleagues should be encouraged to speak out on the reforms, and full material should be gathered to provide ammunition. This should also deal with arguments about the community charge that it would be regressive and costly to administer. It was noted that a lobby was likely to grow for a local income tax and this would need to be tackled. More attention should be

given to explaining the transitional arrangements for the introduction of the unified business rate. Conservative backbench MPs who were doubtful about the merits of the changes would need to be seen individually, but it would also be appropriate for your Secretary of State to write to all Members of Parliament from time to time describing what was proposed and setting out the arguments.

I am sending copies of this letter to Steven Wood (Office of the Lord Privy Seal) and Murdo Maclean (Chief Whip's Office).

*Yours
David*

DAVID NORGROVE

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Department of the Environment.

CONFIDENTIAL

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PRIME MINISTER

COMMUNITY CHARGE: TRANSITIONAL ARRANGEMENTS, ILEA AND LONDON
[E(LF)(87)18 & 20]

DECISIONS

The Sub-Committee needs to decide on transitional arrangements for introducing the community charge in England and Wales, and in particular -

- a. whether the community charge should ~~simply~~ replace domestic rates completely in year one (as in Scotland) or whether (as envisaged in the Green Paper) there should be a phased transition;
- b. whether there should be a general system of safety nets to prevent excessive changes in the overall level of domestic taxation in each local authority area;
- c. whether special arrangements should be made to deal with very high potential community charge levels, principally in London. This might include action on ILEA's very high spending level.

You may also wish to use this opportunity to consider with colleagues your general stance on the introduction of the community charge, in the light of recent criticism in the Press and elsewhere.

BACKGROUND

2. The Green Paper "Paying for Local Government" recognised that

the introduction of the community charge would involve substantial changes in the burden of domestic taxation, both between individuals within each local authority area, and between areas. It proposed a complex set of transitional arrangements to limit the speed of both sorts of changes -

- a. a phased transition from domestic rates to the community charge, with a period of up to 10 years during which both systems would run in parallel. This would limit changes in the tax burden on individuals in any area;
- b. a system of "safety nets", operated through the grant system, to prevent any change in the burden of domestic taxation as between local authority areas. The grant adjustments would be fixed in cash, and would diminish only as they were eroded by inflation.

The Green Paper recognised that these arrangements would, during the transitional period, blunt the increased accountability which was a major aim of the new system. To deal with this problem, a power similar to selective rate capping was proposed "to prevent irresponsible authorities from imposing excessive burdens on their taxpayers". (Green Paper: paragraph 5.28).

3. Similar transitional arrangements were proposed for Scotland. But during the Parliamentary consideration of the Scottish legislation there was pressure, backed by Scottish councils, to move straight to the full community charge, with no transitional arrangements to phase out domestic rates. E(LF) agreed on 24 February (E(LF)(87)2nd Meeting) to drop phasing, and the Bill was amended accordingly. However safety net arrangements are still proposed to limit shifts in the burden of taxation between areas in Scotland.

MR RIDLEY'S PROPOSALS

4. Mr Ridley now proposes to dispense with most of the transitional arrangements proposed in the Green Paper. He seeks agreement -

- a. to abolish rates completely in 1990, and introduce the full community charge;
- b. to dispense with any general safety net on changes in average tax bills.

In his view the Government's main problem is the very high level of community charges which will have to be levied in some areas because of excessive spending. The problem is worst in inner London, where the ILEA's expenditure alone results in community charges £246 above the standard national figure for spending at assessed needs. Where the boroughs are also high spenders, this results in some very large community charges - e.g. £769 in Camden and £674 in Tower Hamlets, compared to a national average of about £205 per adult.

5. Mr Ridley sets out a number of possible options to help deal with these high charges, out of which he favours -

- c. providing in legislation for a limited scheme of safety net grant to mitigate the highest community charges, but without any commitment at this stage to use these powers;
- d. possibly an interim scheme of community charge capping (but no permanent scheme);
- e. a new examination of the merits of annual elections (by thirds), in London at least.

6. Mr Ridley concedes, however, that none of these proposals is likely to solve the problem of high community charges in London. He therefore suggests that only "direct action on ILEA" will successfully tackle this problem. Elsewhere he suggests bringing forward the date at which boroughs can opt out of ILEA, and ensuring that the terms do not require them to inherit ILEA's high spending; and reconsidering the earlier decision to allow schools to opt out at the same level of funding as they would have received

from ILEA. But, without being specific, he clearly also has in mind more radical solutions, such as direct intervention to reduce ILEA's spending.

MR BAKER'S PAPER

7. Mr Baker's paper does not really tackle these issues. It is concerned with the legislative and procedural arrangements for implementing your Manifesto commitment to allow inner London boroughs to opt out of ILEA. Mr Baker sees no realistic prospect of boroughs opting out before 1 April 1990, when the community charge will be introduced. Nor does he anticipate any substantial reductions in expenditure in year one, although he does expect benefits in later years. He notes that the Government will need to bring pressure to bear to reduce spending in a slimmed down ILEA after opting out. But his paper contains no proposals designed to achieve this. It does however make one proposal which is likely to prove very controversial: that he should have a reserve power to require authorities which are still in a rump ILA to opt out at some stage.

MAIN ISSUES

8. Mr Ridley's proposals represent a radical rethinking of transition to the community charge, with the aim of introducing the Green Paper system in full in the quickest possible time. This has substantial attractions. But it will involve much sharper gains and losses. You need to decide whether these are politically acceptable; and indeed whether you are willing to take decisions now without seeing full exemplifications of the effects on individuals, households and regions.

The ILEA

9. Mr Ridley is obviously right to highlight the problems caused by ILEA - if it spent at its assessed needs, the problems of high community charges in inner London would be much reduced. But Mr Baker is probably also right in saying that existing policies on

opting out cannot take effect in time to help much. Equally, tinkering with the financial arrangements for individual schools to opt out is unlikely to help unless they do opt out in substantial numbers - which a less favourable financial regime is hardly likely to encourage. You will therefore need to consider whether to explore more radical options of the sort Mr Ridley hints at, though Mr Baker will claim that the Manifesto precludes him from going anywhere near as far as Mr Ridley would wish. You might like to take this issue first, because it determines the magnitude of the problems which arise with Mr Ridley's other proposals. You will also wish to consider whether to approve Mr Baker's proposals on procedures for opting out, and particularly the suggestion of a power eventually to compel reluctant boroughs to opt out. It is not easy to see how this would work with a hostile authority.

Abolition of Rates

10. To move straight to the full community charge in 1990 will mean that both gains and losses occur immediately. Many people paying rates at present will move straight onto a much lower community charge. Conversely, those making no contribution to rates now will face an immediate liability for a full charge of over £200 on average. This is the course the Government has now adopted in Scotland. It has the substantial benefit of getting rid of domestic rates immediately, rather than retaining them (at a diminishing level) for ten years or more in some areas. There is a consequent saving on administration, which Mr Ridley estimates at £50 million annually. You will want to weigh these advantages against the political dangers inherent in much larger gains and losses in 1990. You would also need to be sure that an entirely new and untried tax could take the full weight of local authority spending in 1990/91, particularly in inner city areas where it may prove hard to collect.

General Safety Net

11. If you agree to abolish domestic rates completely in 1990, the safety net proposed in the Green Paper no longer makes much sense.

There will be very substantial changes in the liabilities of individuals in each area, which will not be prevented by a safety net designed to limit changes in average domestic tax bills between areas. If a non-ratepayer in, say, Surrey can move straight onto a charge of £200, there is no reason in logic why a non-ratepayer in, say, Durham cannot do the same. But against this you will want to consider the implications for concern over the North/South divide of a very sharp shift in the burden of domestic taxation in favour of the South East in particular.

Transitional Grant to prevent high Community Charges

12. Annex B to Mr Ridley's paper describes a scheme which would allow him to pay additional grant to areas where the community charge would otherwise be excessive, principally in inner London. The illustrative scheme provides extra grant to areas where the charge would otherwise exceed £350 per adult, with the aim of reducing the charge to this level in year one. In the subsequent year the transitional grant would be halved, and it would disappear in year three. The cost of this scheme is estimated at £390 million in the first year, and £195 million in the second. Mr Ridley suggests that the cost could be met either by the Exchequer, or by community charge payers elsewhere (at a cost of £12 each in year one). There would be an offsetting saving in reduced benefits of more than £100 million in year one.

13. In the absence of more direct action on ILEA or a more general safety net, a scheme of this sort provides the only sure mechanism for substantially reducing the level of the highest community charges in 1990. But it has substantial disadvantages -

- a. it takes the pressure of the new system off the highest spending authorities in years one and two. They might also seek to manipulate their finances to maximise their benefit from the transitional grant;
- b. it brings all high community charges down to a certain level, irrespective of differences in spending by the

authorities concerned, for example, Wandsworth would have the same community charge as Camden in 1990/91 (because ILEA's spending pushes the Wandsworth charge above £350, despite the borough's own relatively low budget);

c. it provides only a temporary respite from very high charges, which would apply in full in year three.

d. it pushes the Government right to the front in settling the effective charges in the most sensitive areas.

You need to decide whether the advantage of avoiding very high charges in 1990/91 outweighs these disadvantages. If so, you might want to adopt that as your policy now, rather than simply taking the powers as Mr Ridley suggests, with the risk of appearing later to have been pushed into introducing a scheme as a response to opposition.

Community Charge Capping

14. You need to decide whether you want to introduce powers to cap the community charges of high spending authorities after 1990, either on a temporary basis or permanently. Mr Ridley believes that a permanent scheme contradicts the arguments of accountability which form the basis for the community charge. He argues that a temporary, transitional scheme might have some advantages, but could also lead to the Government taking part of the blame for very high charges. Annex A to his paper sets out his proposals for how such a scheme might work. It follows the Scottish precedent (which has been incorporated in the new Scottish financial system) rather than the rate capping regime which has applied in England since 1985/86.

15. There are clearly very major issues here. If you agreed with Mr Ridley and dispensed with capping - at least in the long term - you would have to rely entirely on the greater accountability provided by the community charge. You would not be able to intervene, even if some high spending authorities levied very high

charges indeed. On the other hand, capping may simply transfer part of the odium of high charges to the Government. If you also went for a scheme of transitional grant to mitigate the highest charges in the early years, you might have to endorse steeply rising charges through capping (e.g. for Camden £350 in 1990/91, £559 in 1991/92 and £769 in 1992/93). This is not an attractive prospect. You will probably not want to do more at this meeting than decide in principle whether you want community charge capping. If so, you might ask Mr Ridley to develop his proposals in detail in another paper dealing solely with capping, and to provide figures for the sort of community charges the Government might have to impose.

Elections by Thirds

16. The suggestion that all local authorities should be elected by thirds has been considered in the past and rejected, most recently by the Widdicombe Committee. Its proponents claim that having elections in three years out of every four would increase accountability. But the evidence of councils where it already applies - which include many metropolitan districts including Liverpool - is not particularly encouraging. To make it work properly would involve extensive re-working of local election boundaries to create three Member wards everywhere. If you wish to consider it again, you will want to ask the Home Secretary to bring a paper to the Sub-Committee. You may also wish to explore Mr Ridley's less radical proposal for bringing forward the May 1990 elections so that they take place before final community charges are set - this could be done under existing legislation.

VIEWS OF OTHER MINISTERS

17. Mr Baker will strongly resist Mr Ridley's proposals on ILEA. He is also likely to argue for retaining the original transitional proposals, for which he was largely responsible. The Social Services Secretary is likely to be concerned about the implications of the proposals for the benefit system. The Home Secretary will probably resist the proposal on elections by thirds, but may be


more receptive on moving the date of the 1990 local elections if colleagues see benefits in this. The Secretary of State for Wales is likely to seek flexibility to introduce rather different transitional arrangements in Wales: he has no problem of very high charges, but will be concerned about some very high percentage increases in domestic taxes. The Chancellor and the Chief Secretary, Treasury will of course be concerned about the public expenditure implications, including the cost of the proposed transitional grant and any increased benefit costs. They may also argue for retaining domestic rates for a transitional period for prudential reasons; and for exploring alternative approaches to the London problem, such as retaining a purely local contribution from business ratepayers (as is proposed for the City).

TIMING

18. The main constraint is the need to get the Abolition of Domestic Rates Bill drafted in time for introduction soon after the Recess. To achieve this, you will need to take final decisions on these issues, and on other issues like the new grant system (which E(LF) is due to consider next Tuesday), before the Recess. Mr Ridley will also need at some stage to make a major announcement about his revised proposals. This should ideally be done before the Recess if a damaging period of uncertainty is to be avoided.

HANDLING

19. It may be helpful to take the question of ILEA first - the Environment Secretary and the Education Secretary will both want to speak on this issue. You might then ask the Environment Secretary to introduce his other proposals. The Home Secretary, Social Services Secretary, and the Chancellor or Chief Secretary, Treasury will wish to speak on certain aspects, and other Ministers will also wish to contribute.


J B UNWIN

Cabinet Office

1 July 1987