cc B/LP

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for back up E(LF)

PRIME MINISTER

E(LF): TRANSITION TO THE COMMUNITY CHARGE

E(LF) is to return on Tuesday to the issue of transition to the community charge in England and Wales, including the problems posed by the ILEA's spending. Mr Ridley will be giving an opening presentation, as you asked, but this minute is intended as a background note for your weekend box, to expose the main issues you will need to consider. We shall submit detailed briefing on the new papers by Mr Ridley, Mr Walker and Mr Baker on Monday.

BACKGROUND

2. The purpose of transitional arrangements is to moderate the changes in tax burdens which will result from the introduction of the new local government finance system. You have already decided (E(LF)(87)7th Meeting) on transitional arrangements for non-domestic rates. They will limit the gains and losses arising from the non-domestic revaluation and the introduction of the uniform national non-domestic rate (NNDR) to a maximum of 20-25 per cent per annum: the largest changes will feed through in full in about 5 years. Because NNDR income will be pooled and distributed to all areas on a per adult basis, this transitional scheme is entirely self-contained: it has no implications for domestic taxpayers. You now need to decide on transitional arrangements for them.

EFFECTS OF NEW SYSTEM ON DOMESTIC TAXPAYERS

3. If the community charge and the new grant system were introduced in full in year one they would lead to two sorts of changes in domestic tax bills -

i. changes between individuals within each local authority area;

ii. changes between areas in the overall tax bill on their residents.

Changes between individuals

4. Within each area, the switch from rates to the community charge would broaden the burden of local taxation from householders to all adults. As far as households are concerned, 80% of single person households would stand to gain; among those with two adults gainers and losers would be evenly balanced; and 75% of those with three or more adults would stand to lose. Households in dwellings with high rateable value (RV) would tend to gain, those in dwellings with low RV to lose. As far as individuals are concerned, ratepayers would tend to gain, and non-householders, particularly young adults, would stand to lose (on the assumption they make no contribution to rates at present).

Changes between areas

5. The removal of domestic resource equalisation and the pooling of non-domestic rates would also lead to large shifts in the burden of domestic taxation as between areas. Areas with high rateable values and low spending levels would tend to gain; those with low rateable values and high spending would tend to lose. London is a special case. Although it has high RV's, it has received very favourable treatment through the London resource discount under block grant and its predecessors. A substantial number of London authorities are also very high spending. Consequently domestic taxpayers in the capital stand to lose from the community charge.

6. These effects can be quantified in two ways. In terms of the balance between gainers and losers, about 70% of households in the

Northern region and in Yorkshire and Humberside stand to lose, as do over 60% in London. In contrast, 80% of households in the South East and over 70% in East Anglia and the West Midlands stand to gain. In cash terms the Green Paper gave the following figures for the shift in the burden of domestic taxation (1984/85 figures) -

South East	gain of £470m
West Midlands	gain of £152m
South West	gain of £83m
Northern region	loss of £115m
Yorkshire and Humberside	loss of £155m
London	loss of £475m

TRANSITIONAL MECHANISMS

7. Different mechanisms are needed to deal with the different categories of changes -

i. Changes between individuals. The only practicable way to moderate changes within a local authority area is a phased transition from rates to community charge, with both running in parallel for a time;

ii. Changes between areas. These changes can best be moderated by safety net arrangements, operated through the grant system, or variable payments out of the NNDR pool (or a combination of both).

In addition a special variant of the second approach could be considered as a solution to the problems posed by London, either on a temporary or a permanent basis. The existing resource discount could be replaced by a preferential level of payments through grant or the NNDR pool, or by the retention of a purely local element of non-domestic rates.

MAIN ISSUES

8. The first issue you need to decide is whether you want to moderate changes in tax bills between individuals, by a phased transition from rates to the community charge. If you do, then I suggest that you will also want to introduce a safety net to moderate changes between areas. Otherwise shifts in the burden of taxation between the North and the South will make a nonsense of the phased transition. (With no safety net, the average household bill in, say, Barnsley might rise by 60%. If a £50 community charge were introduced, that would still lead to a 30% increase in all rate bills in 1990/91 on top of an average community charge bill of £100 or so per household. Domestic taxpayers would simply not be protected from sharp changes in bills).

9. A full transitional package like this has some clear advantages -

i. it prevents unreasonable changes in individual tax bills from one year to the next;

ii. it defers the shift in the burden of taxation from the South to the North which is implicit in the new system;

iii. it avoids putting the burden of nearly a quarter of local government expenditure (and the full burden of marginal expenditure) on an untried tax in 1990/91.

But it also has substantial disadvantages -

iv. it masks the greater accountability which is a key aim of the new system. In the transitional period there would be complex and confusing changes in rate and community charge bills, unrelated to the spending decisions of local authorities;

v. it means retaining rates during the transitional period;

vi. it is expensive, costing perhaps £600m per annum to administer both rates and the community charge compared to £400m for the new tax alone.

You need to weigh these pros and cons.

10. If you decide not to have a phased transition from rates to the community charge, you will need to decide whether to have a safety net alone. That would prevent sharp and immediate shifts in the average burden of domestic taxation between areas, and particularly between the North and the South. But it would not prevent large changes in individual tax bills. It therefore has some very questionable effects: for example, a non-ratepayer in Elmbridge in Surrey would be asked immediately to pay a full community charge of £366 (compared to £239 if he did not have to contribute to the safety net). At the same time a non-ratepayer in Barnsley would have his charge limited to £168 (compared to £264 without the safety net) because domestic rateable values in Barnsley are low at present. A safety net alone will not therefore address concern about unreasonable changes for individuals. You need to decide whether it is justified in terms of its economic effects as between areas and regions, particularly the North, parts of Wales and London.

Speed of transition

11. If you decide to have transitional arrangements of either sort, you will want to decide on the speed at which to move to the full Green Paper system. The Green Paper proposed -

i. introducing the community charge at £50 in the first year, with further tranches in subsequent years. Rates would have been replaced quickly in certain areas, but only after 10 years or so in parts of London;

ii. a safety net fixed in 1990/91 to prevent all shifts in the burden of domestic taxation between areas, and then frozen in cash terms indefinitely.

Arrangements of this sort would persist - and distort equity and accountability - for a very substantial period. You will want to decide whether it is advantageous to move faster to get the new system fully in place, and if so, what is the best timing from a practical and political point of view.

Special London arrangements

12. If you have a safety net, that will provide transitional protection for London ratepayers in the same way as for those elsewhere. If not, you could still introduce a temporary cap on the highest charges in London, on the lines Mr Ridley suggested when E(LF) last considered the transition. A special arrangement for London to have access to a purely local non domestic rate or a preferential rate of payments from the NNDR pool therefore seems to make sense, if at all, as a permanent arrangement. It could be presented as a continuation of London's preferential treatment under the existing block grant system. But with the abolition of rates, there is no reasoned justification for such treatment. (Higher costs in London, and in particular London weighting payments to employees, are taken into account in needs assessments, and therefore reflected in higher grant payments to London authorities.) It is arguable that London's favourable position in rating terms has been one factor in the high level of spending in the capital. These points argue against a special scheme.

13. However you may feel that the levels of community charge in prospect in London are so high as to be unacceptable, even with a transitional period. One response would be to seek sharp cuts in the level of expenditure in London, through rate capping and other measures. But experience since rate capping was introduced in 1985/86 does not give great reason for optimism that it will be successful even in holding spending constant in real terms, much less achieving cuts. And, at the last E(LF) meeting, Mr Baker did not think that the available options on ILEA could greatly affect that element of the burden on the local charge-payer in the short term. You might therefore want a special scheme as a purely pragmatic solution to the problem of high community charges in London.

CONCLUSION

14. To summarise, the main issues are -

i. whether you want a phased transition from rates to the community charge, coupled with a safety net on changes between areas, which would limit changes for individuals;

ii. if not, whether you want a safety net alone, which would limit regional changes;

iii. the speed of any transition; and

iv. whether you want special arrangements for London as a pragmatic response to the high community charges in prospect there.

A.J.L.

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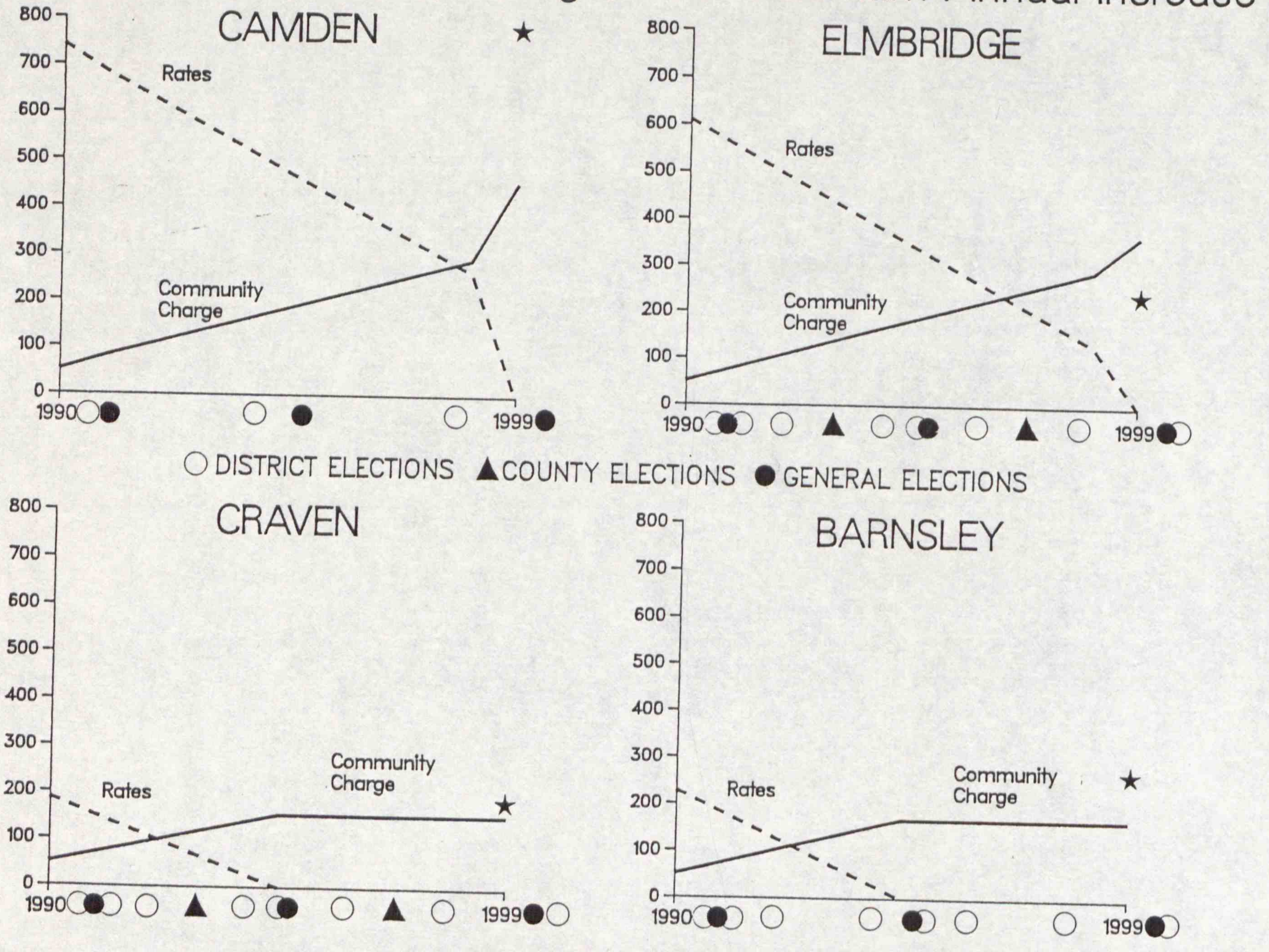
10 July 1987

DUAL RUNNING, FULL SAFETY NET
£50 Initial Community Charge, £30 Maximum Annual Increase



PROPORTION OF HOUSEHOLDS PAYING RATES

Assuming Green Paper transition from rates to community charge

1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
100%	100%	100%	98%	86%	61%	37%	17%	8%	5%
	●				●				●

Key: ● Possible General Election

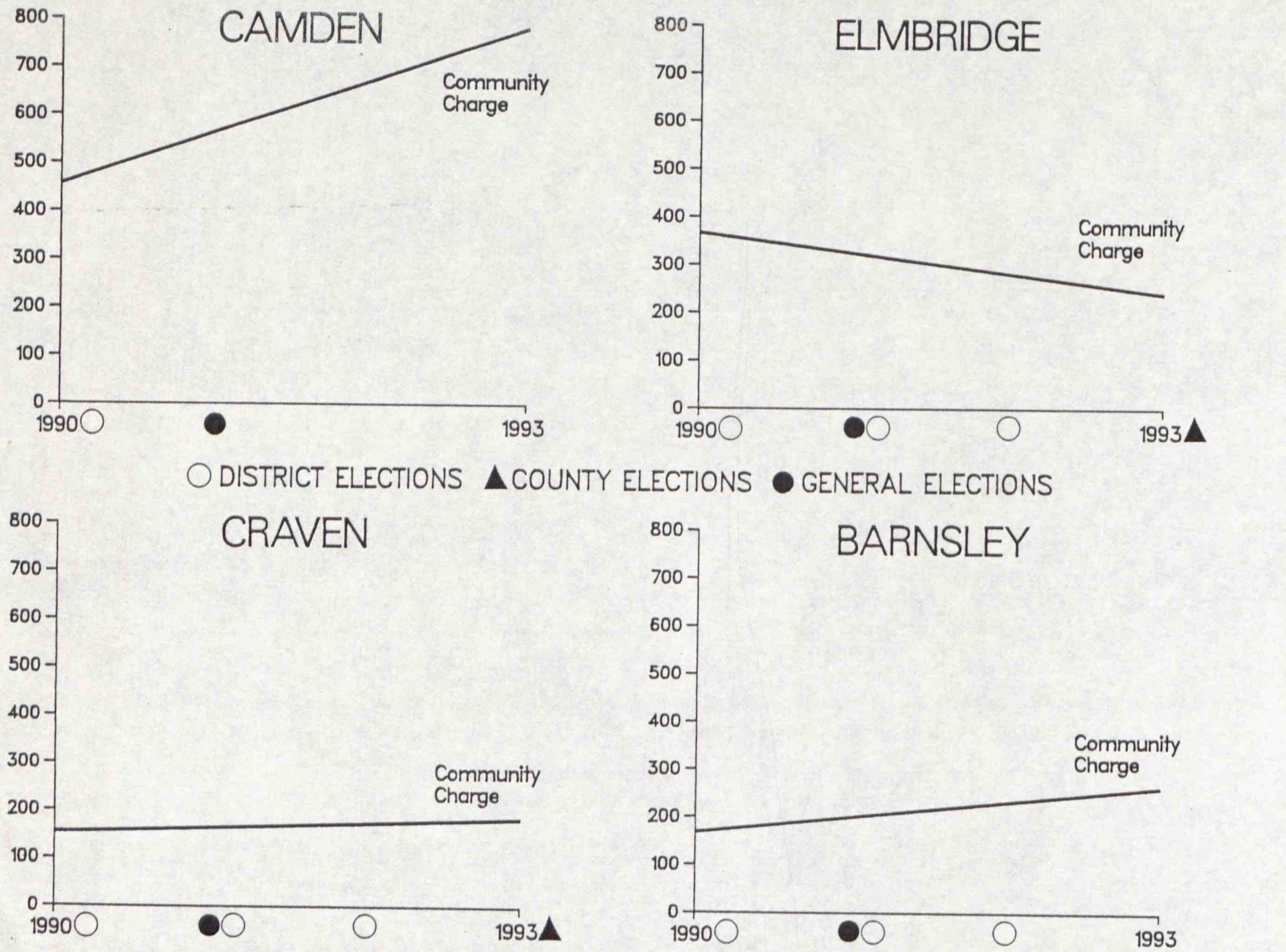
DUAL RUNNING - COST AND REVENUES IN 1990/91

	Domestic rates	Community charge	Total
Revenue	£6200 M	£1800 M	£8000 M
Admin cost	£200 M	£400 M	£600 M

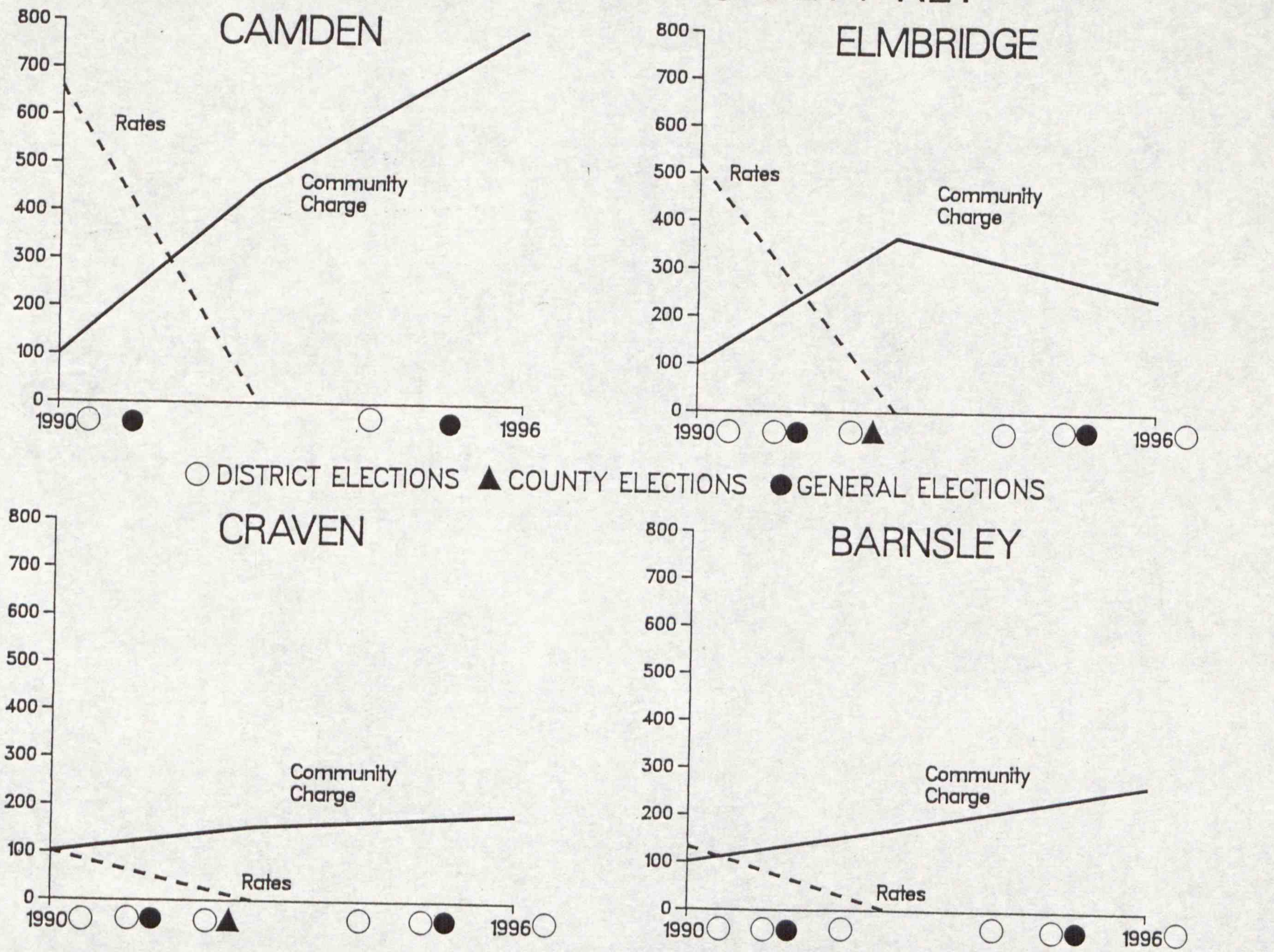
SAFETY NET - EFFECT ON COMMUNITY CHARGE BILLS
(Assuming 1987/88 spending)

	Overspending	Community charge, no safety net	Community charge, full safety net
Camden	£604	£782	£456
Elmbridge	£60	£239	£366
Craven	£6	£184	£154
Barnsley	£86	£264	£168

NO DUAL RUNNING, PHASE OUT SAFETY NETS



INITIAL CHARGE £100: PHASE OUT RATES, THEN PHASE OUT SAFETY NET



PHASE OUT RATES AND SAFETY NET TOGETHER
Initial Community Charge £100