C E

PRIME MINISTER P 03531

## LOCAL AUTHORITY GRANT SETTLEMENT

[Minute of 6 September from the Secretary of State for the Environment; minute of 8 September from the Chancellor of the Exchequer]

**DECISIONS**

1. The main issue for decision is whether further changes should be made in the proposals for the local authority grant settlement for 1990-1991. There are very different proposals from Mr Patten and the Chancellor.

2. Mr Patten proposes action in three areas:

i. to provide about £650m of new Exchequer funds to pay for the safety net. This would relieve authorities who gain from the community charge to get the full benefit immediately, without being obliged to contibute to the safety net.

ii. to be prepared to use community charge capping vigorously in March-July in up to 20 areas. This could reduce some of the highest community charges.

iii. to explore possible changes to the community charge rebate system, to give further help to individuals on modest incomes. (The paper also sets out possible forms of "transitional household relief" to assist losers, but Mr Patten appears not to favour such a scheme on grounds of cost and administrative complexity.)

3. The Chancellor supports the proposal on capping but strongly opposes the proposal to make extra Exchequer money available, either to pay for the safety net or to improve rebates. Instead he suggests:

i. a radically improved presentation of existing policy, to get across the message that the authorities who are complaining are those receiving the greatest benefits from the community charge;

ii. small changes to the safety net to give gainers half (rather than 47%) of their gains in 1990/91, at no extra cost;

iii. an undertaking that all gains will come through in full in 1991-92. This would require a new specific grant to finance the safety net protection for losers in years 2, 3 and 4. The Chancellor proposes that this should be found within the envelope of Aggregate Exchequer Finance (AEF) for those years.

4. You will wish to decide whether the existing proposals for 1990-91 can be defended as the Chancellor suggests, or whether the Government need to find additional money next year to smooth the transition to the community charge. There are a variety of intermediate positions between Mr Patten and the Chancellor, involving some new money but less than Mr Patten is proposing, on which more work could be done.

5. Finally, you will wish to decide the timing of any announcement: Mr Patten proposes an early announcement to seize the initiative, while the Chancellor would prefer a later announcement. Whatever changes are agreed will need to go to E(LG) for formal approval.

**BACKGROUND**

6. The main elements of the safety net package announced by Mr Ridley on 19 July are:

i. losing authorities will have their losses limited to

£25 per adult in 1990/91;

ii. gaining authorities will contribute 53% of their gains to finance the protection for losers, subject to a maximum contribution of £75 per adult;

iii. authorities with very low rateable values will be paid a new specific grant to eliminate their losses of £25 per adult under i. above (total cost £100m);

iv. inner London boroughs taking over education from the ILEA will be paid a new transitional specific grant totalling £100m.

**MAIN ISSUES**

7. The next few weeks provide a last chance to stand back and review the arrangements for the community charge before the Department of the Environment start implementing the local authority grant settlement for 1990-91. If there is to be new money to ease the transition, it will be important to ensure that it is used effectively. The immediate focus of attention is on the safety net which is directed at the tax burden between different authorities. As the introduction of the community charge approaches next spring attention may well switch to the impact on individuals and householders.

**More money for the safety net**

8. The present safety net defers part of the major shift in the burden of domestic taxes between areas which will ultimately result from the community charge. It therefore retains part of the existing cross subsidy from high-rated areas (eg the South East) to low-rated areas (eg the North). Gaining local authorities and their MPs want their full gains to come through in year one, so that they can set their initial community charges at the long-term level.

8. The Chancellor argues that what is needed is not more money but an improvement in the presentation of existing policy, to get across the message that these authorities are the gainers from the community charge, and moreover that they are getting nearly 50% of their gains in the first year. He suggests that they should be promised the remaining 50% of their gains in year two, 1991/92. The safety net protection for the losers would then need to be financed from Exchequer grant for the final three years: he suggests this should be found within the AEF envelope each year. The policy could then be presented on the basis that gainers were getting their full gains in two stages, while losses were being phased in over four years.

9. You will wish to consider whether there is a real possibility that public understanding of the issues can be reversed in the way that the Chancellor proposes. However rational the case is, it might still be thought paradoxical that the Government would be willing to shoulder the costs of the safety net from 1991-92 onwards but not in 1990-91. It might simply lead to even greater pressure to introduce the new specific grant in year one.

**Mr Patten's proposal**

10. In contrast to the Chancellor's package, Mr Patten's proposal would respond directly to the concerns of gaining authorities and MPs. Its main advantages are:

i. it would allow all gains to feed through in 1990/91;

ii. it would improve accountability. The new system would apply in full in about half of all local authorities in 1990/91, unobscured by safety net adjustments;

iii. it would reduce the average community charge (for any given level of spending) by £18 per adult, which might in turn reduce the increase in the RPI by about 0.4 percentage points from April 1990.

11. The main disadvantages are:

i. it would involve a further large addition to the Planning Total, adding to the difficulties of the current public expenditure round;

ii. it might encourage local authorities to spend more, which would add to General Government Expenditure (GGE), and to inflationary pressures in the economy;

iii. the additional money would go entirely to the areas which gain from the community charge. This might do little to help those individuals who face the sharpest changes in tax bills.

12. You will want to decide whether the Government now need to make additional money available to smooth the transition to the community charge.

**Intermediate options**

13. If you felt that extra funds needed to be made available, but that £650m was too much, you might want to explore cheaper alternatives. Options might include:

i. funding only a further part of the safety net, leaving gainers to meet the remainder. For example, the Exchequer might meet half the cost (£325 million), requiring gainers to contribute a quarter of their gains in 1990/91;

ii. funding the safety net in full, but reducing the cost, perhaps by increasing the limit on losses, eg to £35 per adult. This might however be difficult politically, following Mr Ridley's statement in the House on 19 July;

iii. funding the safety net through specific grant, but making only part available as new money. For example, half (£325m) could be found within the existing AEF total. This would however add to the community charge for standard spending (CCSS), and increase actual charges in all areas not in the safety net.

You might wish to ask Mr Patten and the Chancellor to prepare options of this sort, for consideration at a further meeting.

**Individual losers from the community charge**

14. The safety net will operate at authority level: it will not provide protection for individuals who lose from the community charge. The impact of the community charge on individuals has not yet aroused the same public pressure as the safety net. But it may assume as great or greater prominence as 1 April 1990 approaches.

15. Annex C to Mr Patten's paper discusses the possibility of introducing a new scheme of "transitional household relief" to be operated by the Government. Such a scheme would seek to reimburse some categories of people whose losses exceeded a certain level (eg £2.50 per week). But Mr Patten argues that any such scheme would pose formidable administrative problems and be very costly, given that it probably could not be means-tested. You may conclude that it is not a realistic option at this late stage.

16. Mr Patten therefore proposes that possible improvements to the community charge rebate scheme should be explored. There are three main options:

i. reducing the benefit taper. The Government have already announced a cut from 20% under rate rebates to 15% under the community charge. A further cut to 10% might cost

£250-300m per annum and extend rebates to 2 million additional claimants.

ii. increasing the capital limit. A doubling of the limit to £16,000 might cost up to £80m per annum, and extend rebates to 700,000 additional people.

iii. increasing the earnings disregard. Doubling the disregard would cost up to £70m per annum, and make 600,000 additional people eligible for benefits.

17. The Chancellor argues against any further extension of rebates. He points out that the rebate scheme is expected to cost £2 billion next year, compared to less than £1.5 billion this year, and that 11 million chargepayers will be eligible for rebates (Great Britain figures). The Government have recently made concessions on the taper and the capital rule, for which he suggests full credit has yet to be taken. Apart from cost - in what is already a difficult public expenditure round - further concessions would add substantially to the number of people dependent on benefit.

18. Mr Newton already has work in hand on the capital limits for rebate, following your Private Secretaries' letters of 24 July and 9 August. You will want to decide whether that work should continue, and whether any of the other options listed above should be pursued.

**Community charge capping**

19. Mr Patten and the Chancellor agree on the need for a vigorous use of the capping powers, to select perhaps 20 authorities. Mr Patten suggests this might help to keep community charges below £350 in all but some 10-20 authorities. The main question is whether in March-July it will prove possible to cap this many authorities, and to impose substantial reductions in their community charges. No authorities were

capped in Scotland this year, despite strong representations from the then Chief Secretary. You may wish to ask Mr Patten to ensure that the technical and legal pitfalls are anticipated and avoided in England.

**TIMING**

20. Mr Patten sees advantage in making an early announcement about any revised safety net proposals. The Chancellor argues that any early concessions could be damaging to the conduct of the public expenditure round and to market sentiment. He appears to favour a delay at least until Parliament reassembles. You will want to decide when any announcement should be made.

21. Whatever the timing of an announcement on the safety net, there might be a case for delaying any announcement on community charge rebates until the nature and extent of public concern over the effects on individuals are clearer.

RTJW

**R T J WILSON**
**Cabinet Office**
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