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LONDON SW1A 2AA

14 September 1989

From the Private Secretary

Dear Roger,

LOCAL AUTHORITY GRANT SETTLEMENT

The Prime Minister held a meeting this afternoon to consider the local authority grant settlement. Those present were the Chancellor of the Exchequer, the Chancellor of the Duchy of Lancaster, your Secretary of State, the Chief Secretary, the Minister for Local Government, Department of the Environment (Mr. Hunt), Professor Brian Griffiths and Mr. Richard Wilson (Cabinet Office). The meeting had before it your Secretary of State's minute of 6 September, and the Chancellor of the Exchequer's minute of 8 September.

I should be grateful if you and copy recipients would ensure that no further copies of this minute are taken and that it is seen only by named individuals.

Your Secretary of State said that there was no doubt that the Community Charge would be a better system than rates. But the transitional problems would be very great. The two issues were how to fund the area safety net and the pattern of individual gainers and losers. Attention thus far had been focussed on the first aspect, but this may have been a surrogate for the second which would come increasingly to the fore. He had carefully considered the revised package announced by his predecessor in July, and was firmly of the view that the difficulties with it could not be overcome by zero-sum solutions. The proposals the Chancellor of the Exchequer had put forward for minor adjustments to that package would involve, for example, taking away from some authorities in London money they were now expecting to receive, and this would be bitterly resented. This game would not be worth a candle just to finance an increase in the proportion of gains coming through in the first year from 47 per cent to 50 per cent. He had also concluded that there was no sense in making any move to transfer only part of the cost of the area safety net to the Exchequer: it was a question of all or nothing.

Against that background he had reluctantly come to the conclusion that it was essential for the Exchequer fully to fund the area safety net. This would bring a number of major advantages. Accountability would be greatly improved, benefits would accrue to 210 constituencies in all, and some 21 million people would pay lower community charges, including many losers in gaining authorities. The adverse effect of the introduction of the community charge on the RPI would also be eased.

Continuing, your Secretary of State said he felt it was also for consideration whether some further action was needed to deal with the problem of individual losers. But he felt that extensions to the community charge rebate scheme would not be appropriate. This would serve to increase costs and benefit dependency indefinitely, and would not in any event address the problem of people who were just above rebate levels. If colleagues were minded to take further action to ease the problem of individual losers, the better route would be to provide for interim targeted household relief over a 3-4 year period. The cost would however be high: preliminary figures suggested some £300 million in the first year if maximum losses for those households who had previously paid rates were to be limited to £2.50 a week.

The Chancellor of the Exchequer said that an area safety net had always been an element of the community charge proposals going back to the 1985 Green Paper. This eased the introduction of the community charge in a broadly satisfactory, if rough and ready, way. He agreed that there was no satisfactory half-way house between the July package announced by the former Secretary of State and full Exchequer financing of the area safety net. But he considered that the extent of pressure from Government supporters for Exchequer financing of the safety net was now on the wane. And he did not believe that, against the general public expenditure background, there could be any question of finding an additional £650 million. This would involve extremely indiscriminate assistance, extending to many individual gainers without any assurance that the money would be used to reduce the community charge. Such a step would not bring political advantage.

Continuing the Chancellor of the Exchequer said he had put forward the alternative proposals in his minute in an attempt to meet the problems identified by the Secretary of State. But he recognised the difficulty in the proposal to raise the proportion of gains coming through from 47 per cent to 50 per cent, and if the Secretary of State was not attracted to this, he would not press the idea. He attached much greater importance to the proposal to allow all gains to come through in the second year of the community charge, with specific grant to losing areas continuing and being financed from within the overall total of Exchequer grant. There would be considerable attraction in making this major step in Spring 1991.

In discussion the following main points were raised:

(i) It was not sufficient to contemplate a supplement to the July package simply in relation to 1991-92, with no action in 1990-91. The introduction of the community charge next April was dependent on approval of the Parliamentary Order covering the grant settlement in January 1990. As the safety net proposals for 1990-91 currently stood, they were unlikely to get through the House.

(ii) It was essential to identify the key problem, and to ensure that any additional assistance was clearly directed to it. Although Parliamentary pressure thus far had focussed on the area safety net, it was increasingly clear that the real problem was that of individual losers, particularly in authorities who were contributors to the area safety net. The position of people who were overall gainers as compared with rates, even though they might be in authorities contributing to the area safety net, did not cause significant difficulty. On this view the crucial comparison was between, on the one hand, the cost that 2-adult households would face under rates after allowing for an RPI uplift and, on the other hand, the community charge for two adults. It was this type of comparison that, when the community charge system was being designed, had led to consideration of transitional arrangements involving dual running of both rates and the community charge; but that approach had been rejected because of worries that the community charge would then be viewed as an additional tax.

(iii) If individual losers were the key problem, the need now was to consider whether any alternative transitional scheme to dual running could be designed that would limit individual household losses. But there were major difficulties with this. It was hard to see how to graft on a scheme for a transition from a property-based to an individual-based system. Little or no information was currently available about the likely extent of individual losses. And if some maximum was imposed on the extent of individual losses under the community charge, that might encourage local authorities to push up their spending in the knowledge that vulnerable households would be protected by the Exchequer from higher community charges.

(iv) The Chancellor of the Exchequer's proposal for allowing all gains to come through in the second year would not be perceived as being financed by the Exchequer since the cost would come out of the predetermined envelope for local authority grant. The additional cost would therefore fall on the generality of community charge payers. This would be evident to those who studied the figures for 1991-92 in the forthcoming Autumn Statement. On the other hand, it was argued that it was not possible for commentators to interpret the Autumn Statement figures to that degree of accuracy.

(v) The estimates of the likely impact on the RPI of the introduction of the community charge next April were a major cause for concern. On the basis of the present safety net, if local authority spending proved to be 11 per cent higher than in 1989-90, this could add 1.1 per cent to the April RPI, compared with the impact from rates of 0.4 per cent in April 1989. This would therefore add 0.7 per cent to the year on year change in the RPI. This effect would come at a critical time and would also add, directly or indirectly, to upward pressures on public expenditure. But if the Exchequer was fully to fund the area safety net the direct RPI impact from the introduction of the community charge could be reduced by 0.4 per cent. That could prove very important in the counter-inflation fight. On the other hand, it was argued that it would be a mistake to attempt to fine tune the RPI in this way; the key to bringing down inflation was to have in place an appropriate fiscal and monetary policy, which would be undermined if public expenditure was allowed to get out of control. It was also argued that the suggested 1.1 per cent impact on the RPI was exaggerated since local authority spending was unlikely to rise by as much as 11 per cent. Moreover, extra Exchequer grant could certainly not be guaranteed to reduce community charges; many authorities would simply spend the extra grant. In considering possible options an important point to be investigated was whether community charge rebates or any scheme for interim household relief would score as an offset to the RPI.

rejection by Adv. Comm.

(vi) Consideration had to be given to means to prevent any extra Exchequer grant feeding through to additional local authority spending. Community charge capping was one approach. Another would be to specify that extra grant would only be given to individual local authorities if they did not exceed the community charge for standard spending, or that grant would be progressively reduced to the extent that it was exceeded. Alternatively, additional grant might only be allocated at a late stage, after local authorities had drawn up their plans; but this would be difficult given that the Grant Order had to go through the House in January.

(vii) The political problems arising from the number of individual losers relative to gainers were exacerbated because the proportion of local authority spending financed from rates/community charge was rising as a result of the cumulative effect of squeezes on Exchequer grant. It was suggested that the proportion of local spending that would be financed in England next year from the community charge would rise to some 30 per cent, but this figure needed to be checked. The relative proportion of individual gainers and losers would also be affected by the actual level at which local authorities pitched their spending; the higher this was the bigger the proportion of losers. On the other hand, it was argued that this sensitivity was relatively low; it would not make much difference to the proportion of losers relative to gainers as between, say, 7 per cent and 11 per cent over-all increases in local authority spending.

(viii) One possible measure that had been suggested earlier was to raise the capital cut-off for pensioner couples from £8,000 to, say, £16,000 or £20,000. But this would cost some £80 million, which seemed too high a figure for the benefits such a change would provide. It should also be borne in mind that many pensioner couples would gain from next April with the introduction of independent taxation for married women.

(ix) If it was decided to bring forward additional Exchequer funding, careful consideration would need to be given to the timing of any announcement. On the one hand there would be great pressure for, and possibly advantage from, an announcement at the time of the Party Conference. On the other hand, it was argued this would be a tactical mistake, and that it would be much better to defer any announcement until, say, the Grant Order was going through the House in January.

Summing up the discussion the Prime Minister said that the Group had reached no conclusions for or against any of the possible options for additional Exchequer grant to ease the introduction of the community charge. They had noted the implications of Exchequer financing of the area safety net as proposed by your Secretary of State, but further work was needed on other possible options. The Cabinet Office would chair a group of officials from the relevant departments for this purpose; only a strictly limited number of named officials should have access to the papers. The further work should start by considering the extent of possible individual losers and gainers, and then analyse schemes for limiting losses at the household level, either throughout England or just in the losing areas. In assessing individual losses one key comparison was between the position 2-adult households would face under rates (allowing for an inflation uplift) and the community charge. It was also desirable that schemes for limiting individual losses should meet two other criteria; first they should be transitional, and second they should offset the RPI effect of the community charge. The further work should also investigate the suggestion that the share of local authority spending to be financed from the community charge might rise to some 30 per cent. The further work should be carried out as soon as possible, with a view to another Ministerial meeting in a fortnight's time.

I am copying this letter to the Private Secretaries to Ministers attending, to the others present at the meeting, and to Trevor Woolley (Cabinet Office).

Yours,
Paul

(PAUL GRAY)

Roger Bright, Esq.,
Department of the Environment.