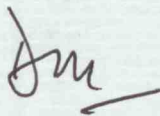


PRIME MINISTER

When you saw Kenneth Baker's report of Michael Heseltine's talk on Oxford Radio about the community charge and his position (Flag A), you asked for a summary of the changes Mr Heseltine invented to local government. I attach a note on this prepared by a DoE Special Adviser. I think the conclusion is right on pages 3 and 4 that Mr Heseltine saw the failings of the old system and tried ever more arcane but unsuccessful methods of dealing with it, because he refuses to recognise that the only sensible way to deal with the problems he encountered was to reform the rating system.



DOMINIC MORRIS

7 March 1990

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LOCAL GOVERNMENT FINANCE - 1979-83

* Before the present government was elected in 1979 government grant to local authorities was paid out in three ways:

- Needs Grant - based on analysis for actual spending which tended to underwrite spending increases by the high spenders;
- Resources Grant - paid out to most shire districts, Mets and London boroughs to bring their rateable values up to a national standard level - effectively the Government stood in as a ratepayer.
- Specific grants - paid on actual spending for certain areas eg police

* Michael Heseltine introduced legislation in the 1979/80 session to reform this system. It came into force in 1981/82. Its main features were:

- A unitary block grant system bringing together elements of the needs and resources grants (This had been suggested by the DOE to the Layfield Commission in the mid 1970s).
- A system of Grant Related Expenditure Assessments (GREAs) which were meant to ensure that grant was paid more on the basis of need to spend and less on actual spending.

- Support for spending was to be reduced above certain limits so that local ratepayers [domestic and non-domestic] bore a higher share of the marginal extra.
- Targets for spending for all authorities which were designed to stop immediate moves to spend up to the levels at which grant support became less generous. These were announced in late 1980 for the 1981/2 financial year.

As 1981/2 grew near the Government became increasingly concerned that local authorities would not keep to the targets. Early in the financial year holdbacks were introduced. These involved reductions in grant for spending above target levels.

This new system provoked outrage among local authorities:

- the system of holdbacks was regarded by local authorities as an interference in local democracy
- Grant penalties would be imposed on authorities even if they spent below GREAs.
- Grant had to be changed constantly as further evidence became available on actual spending. Final grant payments were established literally years after the end of a financial year.

The system didn't achieve the objective of curbing local spending. Local authority spending continued to grow by $1\frac{1}{2}$ -2% in real terms year after year. Local authorities chose to put up rates instead. As a result Michael Heseltine devised a new system in 1982 which had two novel features:

a) If local authorities spent more than a certain amount above GREAs all the excess would fall on the domestic sector

b) A local referendum would have to be held before a local authority could go ahead with such plans.

This provoked a storm of protest from local authorities and MPs to the effect that this was a cumbersome and unfair interference with a local authority's ability to do its job and that local elections were a satisfactory test of public opinion. It was therefore dropped.

After Michael Heseltine left the Department in 1983 rate capping was introduced by Patrick Jenkin. This was an admission that indirect methods of restraining spending had failed. The first authorities were capped in 1984 - with Portsmouth the only Tory authority.

Conclusion

The period was characterized by one unsuccessful attempt after another to constrain local authority spending through Government intervention. The system became more and more complex and more and more unpopular with local authorities. Virtually every year there were furious rows about grant distribution - quite often featuring Tory Shire areas. There was a hint of a change of approach in 1982 with the idea of Proposition 13 style local referenda, but this was dropped.

Michael Heseltine did not advocate reform of the rating system itself. Nor can he be tied to the policy of the community charge. (The next item on the Cabinet's agenda on the day he left the Government was the Green Paper proposal for a Community Charge!).

In public - at least - he has advocated a policy of continuing with domestic rates without a revaluation. (See speech at Second Reading of Local Government Finance Bill.) In fact one of his first acts as Environment Secretary was to cancel the planned rates revaluation. It can fairly be argued that he himself saw the drawbacks of the old system, made increasingly frantic attempts to deal with them through central government control and ended up failing completely.

Yet he refused to support the only sensible way to deal with the problems he encountered, namely rate reform. Because half the population paid nothing local democracy was breaking down and he did nothing to improve that situation. The 1981 White Paper which he published pretty much ruled out any significant reform. Equally he made the grant system more and more complicated to the extent that local accountability was weakened almost to the point of non-existence. No one knew why their rates went up. (Was it a change of grant or was it a change in spending levels.) The new revenue support grant ensures that every council can charge roughly £278 (leaving aside the safety net). Local voters therefore have a proper ready reckoner against which they can judge their council's spending. This was entirely lacking under his system.

[Dr. Cunningham]

"A long-run solution awaits acceptance that property-based taxes actually make a lot of sense as an adjunct to taxes on incomes and consumption, being relatively fair, cheap to collect and economically efficient."

That is what we believe, and that is the way in which we shall proceed.

There are significant arguments for broadening the local tax base, and we are considering how that might be done. We are committed to the principle that taxes should be based on fairness and ability to pay. Discussions are still in progress with industry, the CBI and commerce about business rates and the implications of the right hon. Gentleman's proposition. In addition, we shall review the functions and duties of local government to re-establish sensible links between it and local government finance.

I make it clear that there is another fundamental difference in principle between Labour's policy and that of the Tories. We shall ensure that local government revenue-raising powers are free from central ministerial control. We value the devolution of powers and responsibilities that are so essential to the success of a pluralist democratic society.

Mr. Ridley: We now have some inkling of the hon. Gentleman's ideas. He has shown himself to be keen that the Standing Committee that examines the Bill should consider all sorts of possible options. I shall make him a fair offer. I shall do exemplifications for every local authority area on the basis of his proposals so that the full impact of them will be understood in every part of the country. Therefore, I should be grateful if he would let me have the full details of what he proposes so that I can ask my officials to prepare such exemplifications. The House will not be short of information about the alternative.

Dr. Cunningham: If the right hon. Gentleman thinks that that is a threat, he cannot have been reading his own written answers. I have put down a question. I have already asked him to do the work and provide the information, and he refused. To get the matter on the record, I shall read from a document on the subject, in answer to my question, which the right hon. Gentleman put in the Library. [Interruption.] I shall quote from the *Official Report* of 9 November. [Interruption.] It is in the Library; the right hon. Gentleman put it there. It is about rateable values and capital values. I shall happily put the question down again tomorrow. [Interruption.] The question is set out. It is long and complicated. It takes up almost a full column of the *Official Report*. [Interruption.] No, I shall not read the question. I am more interested in the answer, but I understand that Conservative Members are not. This is the answer:

"There is no comprehensive data available from which to assess the outcome of a capital revaluation of domestic rateable values"

and

"It is not Government policy to undertake such a revaluation or to provide the information."

That is what the right hon. Gentleman said. Why did not he provide the information then, when he had the opportunity?

There is a glaring omission from the Bill. No idea is given of how a rebate system will work and who will benefit. That is one reason why we tabled the amendment. Conservative Members surely cannot object to the wording of the amendment, as the first part is virtually

identical to the Instruction to the Committee supported by so many of them and the second part, which refers to a comprehensive rebate scheme that would also take account of ability to pay, is taken straight from the Government's own publication on the poll tax in Scotland.

The hon. Member for Ealing, Acton (Sir G. Young) is in his place. I suppose that we should describe his revolt not as a peasants' revolt but as a gentlemen's revolt. Like the gentleman amateurs of old, he really did not want to win. I very much regret, Mr. Deputy Speaker, that it was not possible to select that Instruction to the Committee. That is why we tabled our amendment. We invite Conservative Members to have the courage of their convictions and to support us in the Lobby.

In the face of all the evidence and opposition, and in the face of all reasonable argument and opinion, the Government stagger on from expediency to opportunism in local government policy. As the British people look forward to the next century, the Government look back to the Middle Ages. They now propose a tax without fairness, which is anti-family, which invades privacy, which is a bureaucratic nightmare and which has no vestige of intellectual support. We, in this most historic of Parliaments, are asked to approve a tax that has been internationally rejected and condemned by all other democracies. We should not do so.

6.32 pm

Mr. Michael Heseltine (Henley): I am sure that the House will have listened with fascination to the suggestion of the hon. Member for Copeland (Dr. Cunningham) that we are to have consensus policies from Her Majesty's Opposition. That is the first time that the word "consensus", on anything except their terms, has crossed Opposition Members' lips for a very long time. Its use had all the credibility of inviting the turkeys to agree the date of Christmas. Opposition Members can agree consensus only among an ever-decreasing number of voters. That probably explains their disgraceful treatment of my right hon. Friend the Secretary of State whom they tried to shout down.

Conservative Members' commitment to abolishing the rates was first made in 1974 in response to growing resentment about the system. The disease has as much to do with inflation as with the rating system itself. We faced exactly the same phenomenon in 1979, by which time local government manpower had reached record levels and wages were increasing at an unprecedented rate. However, we did not repeat the commitment in 1979. The reason was that our investigations between 1974 and 1979 had produced no attractive alternative to the rating system.

Instead, we began to tackle as best we could in difficult circumstances the root cause of excess manpower and excess wages. The fact that a record number of people were employed and that the vast majority of them were employed by Conservative-controlled authorities in 1979 meant that the Government were not faced with a set of easy options when they first came to power. I had responsibility for drafting the Green Paper of 1981. As many of my right hon. and hon. Friends know, I started with some sympathy for the poll tax—at least as a partial replacement for the rates. However, by the time that consultation period on the Green Paper was over, the idea of a poll tax had no friends. It was dismissed by the

Cabinet with hardly a backward glance. I wish that I could come to the House and say that I won the argument, but in truth there was no argument.

In the last Parliament, this Government achieved a unique degree of constraint of growth in local authority manpower. In 1960, 1.5 million people were employed in local government. By 1970, the figure was 2.2 million, and by 1980 it was the equivalent of 2.7 million. There had been a apparently unstoppable advance under Governments of all parties, but by 1982 we had reduced the number employed to the levels of a decade earlier—in other words, in the period before the reorganisation of local government took place in 1973.

I know that the House will sympathise with me on this matter. No one can tell me of the blood that flowed in the battle that we fought to persuade local government to make those reductions in manpower. But one thing emerged beyond question. If one has to distribute billions of pounds of taxpayers' money to more than 400 authorities to finance 20 major public services, one will never satisfy the recipients. Frankly, if, at the same time, the Government are reducing their share of local expenditure and under-providing for wage settlements, one satisfies the recipients even less. However, it had to be done.

The problem that we faced was how to deal with and act against the profligate while recognising the constructive response that we received from much of local government, controlled at that time by the Conservative party. Rate capping was the agreed solution. A whole range of solutions was explored but rate capping was the solution that the Cabinet agreed should be the way forward. Today, slowly but perceptibly, rate capping is breaking the resolve of even the most obdurate authority. The Cabinet discussed these issues frequently, but I cannot remember a discussion of the option of a poll tax in which it was not rejected as expensive, ineffective and unfair. I shall come to the inherent weakness of such a system later.

The perception of Ministers changed with the experience of government. The first perception that changed was that there were easy economies to be obtained on a grand scale from local government. The Chancellor and the Secretary of State for the Environment talk of efficiency and value for money, and that is quite right. I certainly talked of those things, and there is some scope for savings. During the public expenditure round, the public listen to the Home Secretary pleading for more police men on the beat or to the Secretary of State for Education and Science proclaiming increases in education expenditure, and all the victories of my right hon. Friends in the spending Departments are welcomed extensively on both sides of the House because they are in keeping with many of the aspirations of our society, but they are all victories for increases in local authority expenditure. They are increases stimulated and argued for by the great spending Departments of Whitehall and their Ministers.

There is a second way in which our perceptions have changed. In the summer of 1981, riots swept through eight or nine of our inner cities. Some of us became deeply involved in the brittle fragility of the societies that live there. Nobody disputes the conditions in which they live. One does not need a set of statistics. Just go and have a look. I could not be more in support of the Government's determination to do something about the inner cities, but doing something for them cannot mean making the poor pay more for the worst services in the land. Of course, my

right hon. Friend can point to the extreme authorities. This legislation is driven by the need to curb the excesses of a limited but significant number of extravagant and politically irresponsible authorities.

The consequences of this legislation will be felt in every constituency in the land. It may be the Government's view that they can win their case where they can justify what they are doing against a background of extravagance and extremism, but what will they use for arguments when facing the millions of people who will lose out heavily under authorities which are neither extreme nor extravagant? How will they tell losers in Tory-controlled authorities that the Government must protect the voters from the decisions of their local authority?

After all the battles in which I have had the privilege to be involved in respect of this matter, I start with an instinctive support for a form of local government. I distrust monopoly, whether it be commercial, industrial or political. However, if we start with the suggestion that every authority is going to behave like Lambeth, Camden or Liverpool, then far and away the best solution is to get rid of local government altogether.

Let us consider the proposals. First, the unified business rate is designed to prevent inner-city authorities from milking their business ratepayers, but, of course, there is a price to pay for that. It removes any link between the local industrial and commercial community and any local government. We are creating a new national business tax. I have not the slightest doubt what any Government of any other political persuasion would do with that tax.

With the unified business rate comes revaluation. Revaluation is intellectually unopposable. It is politically disastrous. In 1979 we took a decision not to revalue formally, but the valuation practice has continued. In England and Wales 800,000 are valued or revalued every year. The only real demand for revaluation is coming from—guess who?—the valuers themselves. It is at least curious that a Conservative Government should put the tidy minds of the valuation officers at a higher premium than the anxieties of small businesses and large companies in many parts of the land.

I want to turn to the proposals for a community charge. It is important that people should believe a tax system is fair. Grievances are fed not so much on realities as on peoples' perceptions of realities.

Mr. John M. Taylor rose—

Mr. Heseltine: I shall not give way to my hon. Friend. Other hon. Members will be denied the opportunity to speak unless we make progress.

Of course, there are many grievances about the domestic rating system. We could have dealt with some of the grievances within the rating system, but, having considered them with great care and with the benefit of all the briefing from the Department of the Environment and the Treasury, we decided not to do so. We could, for example, have addressed the problem of families with two or three breadwinners paying no more than a single person in an equivalent house by introducing a single person discount. However, the more we considered the matter, the more we became convinced that it helped significantly the better-off members of the community and we thought that we could help them more by reducing direct tax rates.

Again, we dismissed the argument that only a minority pay. To argue this, because there is only one rates bill per

[Mr. Heseltine]

household, is to argue that families who pay only one bill for rent, telephone, gas, electricity and water do not know what any of these things cost, but, in practice, families work these things out for themselves.

All of these are criticisms of a system that Conservative Members did not create. The most significant change that the poll tax will produce is that we shall be held totally responsible for it. Responsibility for the rates is confused in the legacy of history. Responsibility for the poll tax will now be targeted precisely and unavoidably at the Government who introduced that tax. That tax will be known as a Tory tax.

We argue for the cohesion of the family, yet it will be far easier for young people to evade the tax if they leave home and seek more anonymous accommodation. We urge families to look after their elderly parents, but the elderly relative pays a poll tax at home and none in a local authority home. We will have created a granny tax. Many mothers stay at home to look after their children. The poll tax will send more of them out to work. [Interruption.] I am asked why? The answer is: to pay the poll tax. We already have acute disincentives to work with the existing poverty trap. A poll tax will make it worse.

The rigour of tax collection will become more difficult as urban stress becomes more acute. The Inland Revenue cannot cope now with the burgeoning black economy. The poll tax will bring more tax collectors and more evasion. More evasion will bring more resentment, and the growing scale of rent arrears should be a warning of what lies ahead.

All of these resentments will build on a platform of crude regression which seeks to make equal in the eyes of the tax collector the rich and the poor, the slum dweller and the landed aristocrat, the elderly pensioners living on their limited savings and the most successful of today's entrepreneurs.

This brings me to the argument which is said to be the most powerful of arguments for a poll tax.

Mr. Ian Gow (Eastbourne) *rose*—

Mr. Heseltine: I shall not give way to my hon. Friend.

It is the argument that a poll tax will lead to greater accountability. First, the Treasury will always underprovide for wage settlements in the grant distribution process in order to squeeze wages down. It carefully tucks away its real expectations in the contingency reserve. The Government will be blamed for pushing up the community charge.

Secondly, we have two tier local government. Confusion will not be eliminated by even the clearest demand note.

Thirdly, there is no coincidence in the electoral system between the date on which the increased poll tax is levied and the date on which the council that must account for what it has done seeks re-election. Councils, like Governments, have heard the political message about getting things done in the first year.

Fourthly, virtually nobody knows who their councillors are anyway. Only a small proportion of the electorate vote. Whether people pay rates does not seem to make a great deal of difference to the level of turnout.

Fifthly, incomparably the most important issue in local election results is the prevailing perception of the

performance of the national Government. National opinion polls tell one far more about local election results than the rating policies of individual councils.

I used to be attracted by the argument of accountability, but no longer. The proposals are designed to bring down local authority spending. Even before Second Reading, the concessions that the Government have already had to make, as more and more problems are revealed, have thrown up their own anomalies. It is even possible that the expenditure changes announced will lead to higher public expenditure, especially in the shire counties.

There will be some savings in the inner cities, but my right hon. Friend is already achieving those through his rate-capping procedures. However, to avoid the harsh incidence of the poll tax in inner London, the Government are now committed to phasing in London's poll tax over a transitional period. That means that the non-London authorities will have to pay for London's poll tax in the early years. The Shire counties—they will not be controlled by Conservatives in such circumstances—will fix their initial poll tax at whatever rate is necessary to support their expenditure and the subsidy for London. They will blame the Government for the whole thing. Then, as the London subsidy is phased out, they will increase their expenditure but not reduce their poll tax.

Mr. Ridley: On a point of fact, I should like to tell my right hon. Friend that the special arrangements for London mean not that London will be subsidised from elsewhere, but that inner London ratepayers will continue to pay a proportion of rates as well as a growing proportion of their community charge. There is no subsidy to London in those arrangements. They redistribute resources as between ratepayers and community charge payers.

Mr. Heseltine: I believe that after he made his announcement my right hon. Friend published a schedule showing different levels of projected poll tax outside London as a consequence of his proposals. That must have the effect of confusing the transitional arrangements.

I understand fully the wish to reform. I lived for so long with the pressures that I understand that. Having been through the attempt myself, I cannot but admire the courage of my right hon. Friend in braving the storm that always engulfs a Secretary of State who tries to bring about any reform of local government. However, having said that, my right hon. Friend must know that his proposals cause profound anxiety in the Conservative party. It would be a tragedy if, in the name of reform, we ended up with a worse system than the one with which we began.

I must advise my right hon. Friend that I cannot support the Bill. However, let us be quite clear where the responsibility for this mess lies—it lies with the Labour party. Its savage disregard of its responsibilities has caused much of the trouble with which we are now faced. It is true that there are militants in some Labour authorities, but the authority for Labour militancy comes from the Opposition Benches. Year after year, Opposition Members have supported every disruptive protest, egged on every kinky fetish and tossed around the people's taxes as though they were the autumn leaves. If that has led to a winter of discontent in Britain's town hall, the responsibility lies with the Labour party.

PRIME MINISTER

The Chairman called me to tell me of this.

JHW 29/12

Michael Heseltine MP speaking to Fox PM Local Radio, Oxfordshire, tonight

Quick summary of what he is saying

May I say that as Secretary of State for the Environment from 1979 to 1983, I considered these matters very carefully and persuaded my colleagues in the then Cabinet not to proceed with a poll tax. I believed then as I do now that was the right judgement.

When the Commons came to debate the Community Charge for England and Wales in 1988, I was no longer a member of the Government. I made my opposition clear in the House of Commons both by my speeches and my vote.

However, the new system is now in place. I believe there will have to be changes to the system, but there will be none of any significance this year.

I will continue to take a close interest in this matter and in particular I shall remain convinced that any system of financing local government must be seen to reflect people's ability to pay.