

PRIME MINISTER

P 03657

COMMUNITY CHARGE

[Minute from the Secretary of State
for the Environment of 3 April]

DECISIONS

The question is what changes should be made to the community charge regime for 1991-92. You may wish to use this meeting to clear out of the way issues which you do not wish to pursue further, and to open up the areas on which you wish further detailed work by officials to focus, in particular the options for limiting local authority expenditure.

2. There are three main areas to consider:

i. grant. Mr Patten doubts whether the Government can or should put in enough grant to produce a substantial reduction in this year's average charge of £363. You may wish to defer discussion of grant until a way has been found of ensuring that it does not simply push up local authority expenditure.

ii. limits on local authority spending. Mr Patten believes that comprehensive capping of all local authorities would rebound upon the Government. He favours exemplary capping of rather more high spenders than this year, perhaps over a three-year period. You will wish to decide what further work should be done, in particular on comprehensive capping.

iii. fairness. Mr Patten suggests that Ministers should look at three sorts of targeted measure: flattening the taper, increasing the earnings disregard, especially for young people, and the introduction of some broad reflection of income, perhaps through a community charge multiplier or action on the higher rate of income tax. You will wish to decide whether any of these measures should be pursued.

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3. In conclusion you will wish to commission further work by DoE and the Treasury for another meeting, perhaps in the week of 23 April: the timetable is urgent but there will need to be enough time for intensive study of the options you decide to pursue. Treasury Ministers will also be in a better position to discuss the implications for public expenditure in 1991-92 after their first round of meetings previewing the Survey in late April.

BUDGETS FOR 1990-91

4. Last summer you agreed to set Total Standard Spending (TSS) for local authorities in England at £32.8 billion, 3.8% above their 1989-90 budgets of £31.6 billion. Aggregate Exchequer Finance (AEF) was set at £23.1 billion. It now appears that local authorities are budgeting to spend £36.2 billion, a 15% (£4.6 billion) increase over 1989-90 and 10% (£3.4 billion) above TSS. The result is an average community charge of £363, about £90 above the level implied by TSS.

PROSPECTS FOR 1991-92

5. Current public expenditure plans assume that, before allowing for new community care responsibilities, total spending in 1991-92 will be about £38.2 billion with an increase of £1.15 billion in AEF, giving an average community charge of £398. The DoE paper says that this may be optimistic and that local authority expenditure may rise by 10% in 1991-92, again before community care. This would be another very substantial increase, bringing the rise over 2 years to 27%. Total spending would be £40.3 billion and would imply an average community charge of £450 in the absence of further action by the Government.

GRANT

6. The key decision on Government funding is the level of AEF, the total amount provided to local authorities by way of Exchequer grant and the proceeds of the Unified Business Rate (UBR). Mr Patten says that holding the national average to this year's figure of £363 would mean an increase in AEF of £3.5-£4.5

*Delay
introductions
community
care*

billion, and that over £6.5 billion would be needed to get the charge down to £278. Every £28 off the community charge costs the national taxpayer - via Exchequer grant and the UBR - £1 billion.

7. You may wish to avoid discussion of AEF at this meeting, beyond perhaps giving some general indication of your views on what the objective should be. The Chief Secretary will not want to commit himself until he has at least had a first look at the Survey position in late April; and you may feel that there is little point in deciding to give local authorities more money until a way has been found of ensuring that it will be used to reduce community charges rather than increase spending.

WAYS OF LIMITING SPENDING

8. The DoE paper lists a number of options. You may wish to work through them, bearing it in mind that the best answer may be a combination of elements from several of them. For convenience the brief follows the order set out in paragraph 59 of the DoE paper.

Annual elections

9. 40% of shire district councils have elections for a third of their seats in three years out of every four, with the county elections in the 4th year. Extending this system so that all authorities had annual elections could make accountability more immediate. On the other hand, a study at the time of the Widdicombe Committee found no evidence that annual elections affected spending in the long term.

10. You will wish to decide whether this option should be pursued. Mr Patten thinks it has considerable merit but has reservations about extending legislation this session beyond strictly financial measures: it might stimulate debate on structural issues and look like a panic measure.

Cutting this year's community charges

11. The transitional relief powers could be used to make a cut

in all community charges this year, at a cost of about £3 billion to reduce the charge to £278. The aim would be to reduce the starting point for 1991-92 charges. But it would be seen as validating local authority spending plans this year and would mean a substantial increase in the planning total. Mr Patten says only that whether this is done depends on what the Government's objectives are. You will wish to decide whether it should be pursued. No

Charge capping

12. The DoE paper addresses a number of options on charge capping:

i. conventional charge capping. The paper says that with existing powers it is unlikely that more than 30 authorities could be capped, saving up to £350 million in a year and reducing the average community charge by £10. New legislation to strengthen the rules could increase the number - to perhaps 40-45 authorities - and the resulting savings.

ii. "multi-year" capping. A refinement would be to cap the expenditure of authorities over a number of years so that a programme of phased reductions could be enforced on high-spending authorities. The first year cut in spending might not be much higher, but more could be achieved in subsequent years. You may decide that this is one of the options which needs to be worked up further as part of a possible package.

iii. comprehensive expenditure limitation. This would limit each authority's expenditure automatically, with no element of selection. Mr Patten suggests that the limit could be placed at 5% or 10% above SSA although it is unlikely that all high spending authorities could get down to this level in one year, and it would be necessary to provide a procedure for derogations with a large number of civil servants to administer it. The system would allow

to go up with 3-year capping

overspending of up to 5 or 10% above TSS. You will probably want further work done on this option, exploring the various possible forms it might take.

Another approach to capping

13. These options are not necessarily the only ones. Another possibility would be to apply different limits to each authority by formula, taking their spending levels this year as the starting point. For instance, authorities whose budgets are below SSA could be allowed a 7% increase, those between SSA and SSA + 10% a 5% increase, and those above SSA + 10% only a 3% increase. This system could in principle enforce any given level of spending, although the limits would have to be realistic. A straightforward formula might moreover reduce the need for an extensive bureaucracy which would be involved in dealing with derogations. You may wish to ask for a paper setting out the possible forms which comprehensive capping might take, with the aim of minimising the involvement of central Government in the running of local government.

14. A further possibility would be to introduce a package which included not only capping on these lines but also "multi-year" capping for authorities which were a long way above their SSAs (paragraph 12 ii above), rewards for authorities which were at or below their SSAs (paragraph 17 below) and some form of "safety valve" in the form of a discretion for authorities to supplement their expenditure through charges.

Limiting the income of local authorities

15. If the Government were to decide to increase the amount of local authority expenditure financed by the taxpayer rather than by the chargepayer, one alternative to giving extra grant would be for central Government to raise and collect the money - as with the Unified Business Rate - perhaps through a central community charge set at the level of the SSA (that is, £278 this year); and allow the local authority if necessary to raise the balance of its expenditure through a local community charge within strict limits.

16. In presentational terms this would reduce the overall level of local community charges drastically and might be tailored to meet criticism that the community charge is unfair. But it would be a radical change of direction and DoE say that it could not be introduced in time for 1991-92.

Incentives to reduce expenditure

17. These options are very similar to the system of targets and holdback which operated between 1981-82 and 1985-86. A 1% increase in spending currently adds about 3% on average to the charge. Under these options grant would vary with spending so that a 1% increase might add 5% to the charge. Experience in the early 80s suggests that the main effect of penalties might be to increase community charges rather than cut spending. But the case for rewards for authorities which meet their SSAs, or come in below them, may be stronger.

18. You may want to consider whether a system of rewards for authorities which meet their SSAs, or manage to spend below them, might be a useful addition to a package of comprehensive capping, perhaps along the lines of paragraph 13.

Increased use of specific grants

19. Directing additional Exchequer finance into specific grants ensures that it is spent on particular services. But the risk is that it simply encourages more spending in these areas rather than a cut in community charges. This might be avoided by new Government controls, but these would involve the Government in effect taking over responsibility for the function in question. You will want to consider whether this option should be pursued.

Removal of functions

20. Removing, say, the police and fire services from local authorities without a corresponding cut in Government grant would save them £3 billion, equivalent to £85 off the community charge. But:

i. the Exchequer would then need to finance the services. In financial terms, therefore, this option is little different from providing more grant.

ii. There would be risk that the money released would leak into other services rather than reduce charges.

iii. From the point of view of public expenditure control and efficiency there is not much to be said for 100% Exchequer financing with 100% local authority control.

iv. In any case, Mr Patten says that no changes could be implemented before April 1992 at the earliest, so there would be no effect for 1991-92.

You will want to decide whether you want changes in functions explored as a longer-term option.

FAIRNESS

21. Mr Patten suggests that a major factor in public concern about the community charge is its perceived unfairness. He favours consideration of options to address this.

22. One disadvantage is that further action of this sort may give the impression that the Government accepts the arguments against the principle of a flat rate charge. It also ignores the fact that the social security arrangements associated with the charge are already much more generous than those for rates: around one in four chargepayers (9 million) are expected to get benefit, with nearly one in seven (5 million) on the maximum 80% benefit (GB figures). This is nearly twice as many as received rate rebates. In view of these arguments you will want to decide whether you want further work done in this area.

23. If so, the options Mr Patten outlines are:

i. a more generous taper. Currently benefit is withdrawn at the rate of 15p for each £1 of net income above income

support levels. This could be reduced to 10p at a cost of f400 million. That would help people already on the taper, and bring a further 2.5 million people into benefits.

*Consider for
Community Charge
only*

ii. a more generous earnings disregard. Doubling the disregard to f10 for single people and f20 for couples would cost f80 million and bring nearly 0.5 million people into benefits. If the improvement had to be extended to housing benefit as well the full cost would be about f250 million a year.

iii. introduction of a graduated community charge. Mr Patten suggests that higher rate taxpayers might pay 1.5 times the personal charge, standard rate taxpayers 1 times the charge, and non-taxpayers 0.75 or 0.5 times the charge. This would however cut net income from the charge by perhaps f200 million, which would need to be made up by the Exchequer or higher personal charges. It would also be seen as a major reversal of Government policy, and an admission that a flat rate charge is unfair.

You will wish to decide whether any of these options should be pursued.

R T J WILSON
4 April 1990

*More SSA? (1) VAT on petrol - 5p per gallon
Increase by VAT. 1 or 2 pence per gallon to cut
charge for RPI. I'd like out Council on controlling fund for L.A's
(2) Capital receipts on sold Council
houses or derelict land - use part
for controlling.
(3) Narrower Controls*

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▷ PRIME MINISTER

THE COMMUNITY CHARGE

We are to meet with the Chancellor and Chief Secretary on Thursday to consider whether there are further measures which should be taken on the community charge and related aspects of the local government finance system.

I attach a paper which my officials have prepared after discussion with Treasury, Cabinet Office and Policy Unit officials, to assist our discussion on Thursday. It falls into three parts: the scope for influencing the level of the charge and RPI by increasing Aggregate External Finance (AEF) in 1991/92; measures aimed at limiting expenditure by local authorities; and measures aimed at dealing with public concern about the fairness of the charge.

The paper seeks to provide a thorough consideration of a wide range of options, some of which would cost more than others. Some are likely to be more effective than others. Further study may show that some would be unworkable. Some are of more interest in the longer term since it clearly would not be wise to attempt to implement measures of legislative and organisational complexity in the short time available between now and next March. To the extent that we favour measures for implementation next year which require legislation, we need to reach carefully thought-out decisions within the next few weeks if satisfactory legislation is to be drafted and enacted by the end of October.

I think that you may find it helpful if I offer you some provisional views at this stage.



There is no way back to domestic rates. Too many have forgotten the deep resentment caused by the rating system, particularly by the revaluations in 1973 and in 1985 in Scotland. And I have no doubt that the Opposition do not intend to return to the domestic rating system in its present form.

But we cannot deny the deep discontent with the introduction of the community charge in England, even among many of our supporters. I think that there are three main reasons.

First, the decision to make local authority "gainers" rather than the Exchequer, finance the safety net for the local authority "losers", especially as many of the former were Conservative authorities, and the latter Labour authorities. Secondly, what was perceived, rightly or wrongly, by many of our supporters as an unattainable level of target spending, reflecting a figure for inflation of only 3.8%. I think that this may have led some Conservative authorities to give up any attempt to contain the growth of expenditure at all. And finally, a sense of unfairness by those just above the rebate scale, some of whom are probably first-time home buyers who have faced a sharp escalation in mortgage rates, and who now also face an often-significant increase in outgoings over last year's rate bill.

The first problem - safety nets - will disappear next year since we have already agreed that the Exchequer will finance the costs in the second year.

The second problem we might tackle too by setting a level for total spending and grants which would put within undeniable reach of local authorities a politically tolerable community charge next year. In this connection, I have some doubt whether we can or should put in so much grant that - on paper at least - there would be a very substantial reduction in this year's average charge of £363. When allowance is made for inflation next year and the cost of care in the community, it would mean an increase



in AEF of £3.5-£4.5 billion to hold the national average to this year's figure of £363, whereas our present public expenditure plans provide for an increase of £1.15 billion. Over £6.5 billion would be needed to get the charge down to this year's target figure of £278. (Each £28 off the national average community charge would need a transfer of £1bn from the national taxpayer and is equivalent to eg 0.6p on the basic rate of tax or 0.6% on VAT and about 0.5% off the RPI).

The paper by officials does of course touch upon the takeover by Government of one or more local government services such as the fire and police service, as a route towards reduction of the community charge. But this will only help reduce the level of community charge if the appropriate proportion of supporting grant is left with local government, which can be more readily achieved by a straightforward increase in the rate support grant. In any case, I do not think it would be feasible to do this for 1991/92.

As for the question of fairness, I suggest that we should look at the scope for measures targetted at three different groups. First, there are those with limited incomes who are faced with big increases compared with their rates bills. Though I am reluctant to increase the number receiving benefits, because of the dependency problem, we could improve their position without any inconvenient read-across to the benefits system by flattening the taper to 12.5p or 10p. The latter would bring a further 2.5 million into entitlement in England at an estimated cost of £400m at present levels of community charge.

We could also adopt one or more of the measures outlined in paragraph 51 of the officials' paper to improve transitional relief for those who have formerly paid rates - for example, maintaining relief at the 1990/91 level for the next two financial years would benefit 7.5m people at a maximum cost in England at £90m for 1991/92.



Secondly, there are those paying for the first time - especially young people in training or whose earning power is still low. For them an increase in the earnings disregard is realistically the only possibility but this reads across into the benefit system and would therefore be costly (paragraph 47).

Thirdly, there is the other 'fairness' issue - the fact that higher rate taxpayers pay the same community charge as basic rate taxpayers who are above the rebate scale. It is true that the former contribute heavily to local government costs through the tax system, but we face a problem of public perception. It may be that provided that we can achieve a settlement next year which does not result in significant charge increases, this sense of grievance will subside. And I certainly do not think we should try to relate the level of charge closely to income because we should be in effect be introducing a full-scale LIT system. Another route would be provided by a simple community charge multiplier involving, say, a multiple of more than one for higher rate tax-payers and less than one for non-tax-payers. But this would not necessarily be easy in administrative terms and would mean a system to equalise for differences in income between authorities. It would look very much like the scheme we rejected in the House in April 1988. Yet another way through this issue, which would probably be simpler administratively, might be to look at the higher rate of income tax perhaps to offset more generous rebates for those less well off or to fund part of an increase in general grant.

Whether we provide more money in the current year for a general reduction in community charge payments (via the transitional relief powers, or by some other route), depends on our objectives. Much depends on how far we think it important to deal with immediate discontents about levels of charges and to lower the perceived going rate of the charge; and on the weight we attach to reducing increases in the RPI this year or next

(Not clear:
is Mr Patten
suggesting
an increase
c. 40%
rate hypothecated
to pay for
grant to
LAs?]



year. As I have indicated, it would cost £1bn for each £28 reduction in the national average charge. The issue here seems very simple - do we regard it as a political imperative to reduce the average level of the community charge in the current year?

I am of course only too conscious that the higher the increase in general grants, and the more we support specific categories of chargepayer, the greater the risk that local authorities will spend up, although this risk next year should arise much more with Labour than with Conservative authorities as we get nearer to the General Election. This inevitably leads to consideration of the scope for capping.

I share the view that the great intrinsic merit of the community charge is that it raises the level of interest in local government performance, as we have seen only too clearly. I therefore hope that there would be no place for capping once the charge is bedded in. But I accept the case for capping in the transition, especially if we seek to support spending with grants designed to contain community charge levels. I believe however that comprehensive expenditure limitation affecting all 419 local authorities in England would rebound upon us. It would inevitably precipitate a debate about the independence of local government and the arrogation of power to central Government. Whatever the terms of new legislation, what can be done will be limited by local authorities' diverse and imprecise statutory service obligations, their contractual commitments, the new jobs we ask of them, and historic expectations among local communities about a decent level of services. Pushing on too wide a front will expose the Government to a real risk of going down on judicial review, and losing the public debate about responsibility for "cuts".

It is also the case that in the last 5 years we have never secured reductions by ratecapping of more than 3 or 4% in spending by capped authorities in one year. If this is



multiplied up nationally, comprehensive expenditure limitation would not have for example got more than £30 - 40 off this year's charge of £363. A substantial part of the spending reductions to achieve this saving would have to come from councils run by our own supporters as well as from Labour councils. We could no doubt design the expenditure limits to be more generous to those who were traditionally low spenders - those with budgets below SSA might be allowed larger year on year increases than those with budgets above SSA, and the smallest increases allowed might be for those above some threshold over SSA. This is the route which we went down in setting targets for the holdback system in the early 1980s. The whole process was deeply resented by our supporters in local government and on the back benches. It was in part the strain of that resentment which led us into the reviews which preceded the current reforms.

We have to weigh up whether the risks and disadvantages of comprehensive expenditure limitation are outweighed by the potential expenditure saving. Frankly, if we are to consider expenditure limitation across the board, it seems to me to make more sense to question the power of local authorities to raise their own revenue through local taxes.

What I think that we must legislate for, however, is 'exemplary' capping of rather more higher spenders than this year, and perhaps over a three-year rather than a yearly span, because it takes time for any organisation to turn the spending ship around.

Finally, the paper raises the possibility of shifting all authorities to annual elections, which I think has considerable merit. However, I think that we need to consider carefully whether to extend legislation this session beyond strictly financial measures. To introduce this possibility could stimulate debate on other structural changes and might look like a panic measure.



I am sending copies of this minute to John Major, Norman Lamont and Sir Robin Butler.

CET Bush

PP CP

3 April 1990

(approved by the Secretary of State and signed in his absence)

SECRET

1

SECRET

POSSIBLE MEANS OF RELIEVING THE BURDEN ON COMMUNITY
CHARGEPAYERS

Paper by the Department of the Environment

1. This paper considers possible ways of modifying community charge arrangements. It does so in a preliminary way before officials undertake a deeper study of those mechanisms which appear the most promising. The options considered address:

I. Additional provision for total spending and AEF (paras 6 to 9);

II. Limitation of expenditure (paras 10 to 43); and

III. Fairness (paras 44 to 55).

General points

2. It should be noted that the options considered are not necessarily mutually exclusive: it may well be that a number of measures could be combined to produce the most effective solution. All figures relate to England (GB costs will be commensurately larger).

3. The paper focusses on action which could be taken for 1991/92. But it would be necessary to avoid instability of arrangements from year to year so in practice the schemes described should be considered as if they are to be in place for a number of years.

4. It should also be noted that there is very little buoyancy in the population of chargepayers which varies only with the number of adults of 18 and over. Charges therefore automatically increase from year to year as local authority spending increases whether because of inflation, demographic change, increases in the real level of services, on new tasks such as community care. To the extent that local authority expenditure outstrips the growth of income of this population, charges will take an increasing proportion of that income. This emphasises the need to find means of containing the growth of the charge to a rate close to the rate of growth of incomes.

5. To contain the growth in charges as expenditure grows would mean putting extra Government money into local government in the form of direct financial support to authorities or as extra help to individual chargepayers. But to the extent that this extra money simply encouraged extra spending by local authorities (termed 'leakage' in the rest of this paper), charges would not reduce in line with the extra grant. Initially, payments to individuals are less likely to leak into extra spending. But over time, the degree of leakage would be similar by either route, as authorities budget in the knowledge that their chargepayers are getting help to reduce the burden on them.

I. ADDITIONAL PROVISION FOR TOTAL SPENDING AND AGGREGATE EXTERNAL FINANCE

6. In 1990/91 local authorities in England appear to be providing for total spending of £36.2 billion (£3.4 billion or 10% more than the Government's provision and £4.6 billion or 14½% more than in 1989/90). Current public expenditure plans allow for some increase in 1991/92. They assume that, before Community Care, total spending will be about £38.2 billion, that Aggregate External Finance (AEF) will be £24.26 billion and, as a result, that the average community charge will be £398. Given, however, the level of planned spending, income and the community charge in 1990/91, this may be optimistic. Allowing for inflation and new burdens arising from demographic change and new legislation an overall cash increase in spending of 10% may be more likely before adding in Community Care. This implies total spending of about £40.3 billion and an average community charge of £450 is possible without extra Government help.

7. If spending were £40.3bn in 1991/92 then an extra £3.4bn of AEF over and above that allowed for in present plans would be needed to keep the average charge down to its 1990/91 level of £363. This would give AEF of £27.7bn - an increase of £4.6bn over 1990/91. With this level of charge, there would be a reduction of 1.4 percent points in the annual increase in RPI in April 1991 (most of which has already been allowed for in HM Treasury's inflation forecasts.)

8. Each extra £1 billion of AEF above this level would produce a further £28 reduction in the average community charge and a further reduction of almost a ½ percent in the RPI, assuming that none of the extra grant leaks into higher spending. Conversely each £1 billion less in AEF would increase the average charge by £28.

9. Increases in grant of this order might well have adverse implications for the ratio between Public Expenditure and GDP, and for levels of national taxation and borrowing/debt repayment.

II LIMITATION OF EXPENDITURE

A. ANNUAL ELECTIONS

10. A measure designed to reinforce the effectiveness of accountability under the community charge and thus limitation of expenditure (if electors so wish) would be to introduce annual elections for all local authorities. At present, county councils and London borough councils are elected every four years. Metropolitan districts elect one third of the council in three years out of every four. 60% of shire districts elect the whole council every four years while 40% of them elect one third of the council in three years out every four.

There is some evidence that the pattern of annual increases in spending by counties is related to the election cycle. The introduction of the community charge is intended to enhance electoral participation, and annual election of a portion of every council seems congruent with annual budgetting and billing of chargepayers. However moves in this direction might open up discussion of wider changes in local government structure which could only be implemented against a very long timescale. Furthermore we do not believe that such a change would be introduced in time for the local elections in May 1991 (NB: Local election arrangements are a Home Office responsibility.)

B. CONTAINING LEAKAGE

12. There is a danger that the actual level of the community charge levied by authorities this year will have established a norm in the public mind, and therefore that authorities will feel that they can with comparatively little electoral risk charge in 1991/92 at a similar or slightly greater level. This increases the possibility that any extra grant provided with the object of reducing the level of the charge in 1991/92 may simply leak through into new spending without reducing the charge. It can therefore be argued that a useful preparatory measure would be use the transitional relief powers in s. 13A of the 1988 Act to reduce everyone's community charge liability this year (1990/91) to a level nearer that originally planned by the Government. This would remove from the public mind the idea that £363 was the going rate.

13. The extra grant would not affect the spending base from which authorities would approach their budgets next year as there would be little scope for authorities to feed the extra grant through into extra spending in 1990/91. In terms of presentation authorities would claim that we were simply recognising that they were right all along in their budget proposals, and there is the further disadvantage that relatively low spending areas would claim that the high spenders were getting just as much help as them. It might be seen as rewarding high spenders both in aggregate and by individual authorities. But on the other hand, it would tend to reduce the additional cost of containing the level of the charge next year and provide a better baseline for measures aimed at an actual reduction in the level of the charge.

14. As it costs £1 billion to reduce the charge by £28 the gross cost of reducing the average payment of chargepayers in 1990/91 to £278 would be £3 billion. Against this extra cost, there would be savings of over £600 billion in community charge benefit which is having to be paid out as a result of the average charge of £363. Some of the cost of the existing transitional relief scheme could be saved as well. The net cost of this measure would therefore be around £2.4 billion this year. As it is a reduction in charge for all chargepayers, the whole of the £3 billion extra would go to reducing the RPI by about 1.4 points during 1990/91 rather than in April 1991.

C DIRECT CONTROL OF EXPENDITURE

15. There is a number of possible ways, of varying scope, by which spending by local authorities might be limited directly. But there are limits to the reductions in charges which could be obtained by any form of expenditure limitation. Local authorities have statutory obligations to provide services and they have contractual obligations in areas such as pay. As the capping process works on budgets which are scrutinised at a distance it is not possible to draw a line which shows how much each authority has to spend to meet those obligations. It is also a resource intensive activity for central government and very prone to litigation. This is why rate capping has only been able to achieve relatively small reductions in spending in those authorities which have been capped. This year we are looking for chargecapping to secure a reduction in spending of about 5% of the budgets of the authorities capped.

a. Conventional charge-cappingi. In-year under current powers

16. For reasons of legal consistency and certainty, it is not likely that more than about 30 authorities can be capped under these arrangements in any year. This could reduce expenditure by up to £350 million and the average community charge by up to £10.

ii. In-year but with strengthened powers

17. The current limit on the number of authorities that can be capped stems from legal advice that it is not safe to adopt a criterion lower than expenditure 12.5% in excess of an authority's SSA. It may be possible to provide powers in the primary legislation which would permit capping more safely at a lower margin above SSA or even below SSA where there are excessive expenditure increases.

18. One possibility is a power which bears directly on high charges (rather than an excessive level or increase in budgetted income, as under the existing power). But since the level of the charge flows inevitably from the budgets of the authorities for the charging area it is not clear that it will be possible to look to the level of charge in isolation from the relationship between the authorities' budgets and their SSAs.

iii. Multi-year capping

19. One of the problems with in-year capping is that the scope for capping high-spending authorities may be limited by the fact that they have spending commitments of one kind and another which prevent the maximum reduction implied by the capping criteria from being achieved. There is therefore a case for a power which permits a programme of capping, designed over a period of years to ratchet the expenditure of

the authority down to the level implied by the criteria. This would require a power whereby an authority capped in-year was also designated for capping in subsequent years. Legislation would be needed.

20. Authorities might stay within the scope of capping for the longer of three years or the time taken to reduce spending to the threshold level which triggered capping. A fairly complex process would be required to construct expenditure levels for authorities in years after the first. It would need to take as much account as possible of foreseen new burdens arising from legislation or demographic change. But the resulting caps would have to be provisional and capable of revision to take account of unforeseen changes on both these counts as well as lower or higher inflation than expected when the cap was set. It is not possible to forecast these effects with sufficient accuracy three years ahead to set rigid caps.

21. Because of these complexities, the number of authorities to which it could be applied would be limited. Its effect would probably be to increase over time the number of authorities in capping at any one time to 40 or 45 (assuming that the tendency of authorities to overspend was not otherwise moderated).

22. The first-year expenditure reduction resulting from such a system would not be greater than for in-year capping but there should be a cumulative reduction in subsequent years.

b. Comprehensive expenditure limitation

23. The existing arrangements look to the increased accountability inherent in the community charge as the main instrument for containing expenditure. Charge-capping is an adjunct to deal with a limited number of high spenders, particularly in the transitional period when the safety net and other area grants may blur accountability. The previous paragraphs have suggested ways of strengthening capping powers within this approach. However a more comprehensive system of expenditure limitation is conceivable. This would work by placing a statutory limitation on spending by each authority, say, to a level 5% or 10% above its SSA.

24. If a workable method of comprehensive expenditure limitation could be devised, it ought to in principle be capable over a period of years of delivering with reasonable certainty an overall limit on authorities' revenue spending and hence a community charge at an expected level for any given quantum of AEF. The level of total spending would depend to some extent on the level of TSS decided by the Government for the year and the extent to which it proved necessary to give derogations (see below). And there would be some risk that otherwise low spending authorities will simply spend up to their limit unless a supplementary constraint is imposed in terms of expenditure increases year on year. This would be very unpopular with low spenders as targets were in the early 1980's.

Such comprehensive expenditure limitation would be politically controversial: it would be represented as a further major inroad on the independence of local government, reducing authorities to democratic accountability only for the effectiveness and efficiency with which they deliver their services.

26. Such a system could also put great weight on the SSAs both in aggregate and in detail for individual authorities. Unless the aggregate of SSAs was set at a level commensurate with the local authorities' spending plans (£40.3bn in 1991/92 on the earlier assumptions) then large numbers of local authorities are likely to come within the scope of the comprehensive cap, including those that have traditionally been seen as low spenders. It would also mean that the SSAs for individual authorities would have to be more widely accepted as objective. Needs assessment systems of broadly the current kind have been in operation for more than fifteen years but there has never been a set of assessments which did not arouse controversy as favouring one type of authority over another or as failing to recognise the special characteristics of individual authorities. It is not possible to achieve agreement between all 419 authorities and considerable opposition to such an approach could be expected from all shades of local authority opinion. Such a scheme would make it difficult to change SSAs significantly between years - stability would be vital.

27. Furthermore, an inflexible limit would pose great problems in practice. One approach would be to supplement the limit with discretion for the authority to add to its spending by the product of:

- a. a small discretion to levy a charge above the limit eg £5; or
- b. a small statutorily defined increase to the uniform business rate; or
- c. all or some of the authority's usable capital receipts; or
- d. fees and charges to the users for services now provided free.

28. (a) and (b) have the disadvantage that all or most authorities would as a matter of course take advantage of the discretion and in the course of time it would come to be allowed for in fixing the total of SSAs. (b) would be opposed by the business community who would see it as a reversion to taxation without representation. (c) would be a departure from the Government's previous strong line that capital receipts should not be used to finance current spending. (c) would also tend to be used as a matter of course at least to some extent and the freedom would mean different things for different authorities: shire districts account for a small

proportion of spending but have the capacity to obtain large capital receipts, while counties account for most of the spending but have limited ability to earn receipts. The freedom could be differently defined for different types of authority. On (d) there is already access to fees and charges with certain services excluded from charging. There are powers to stop abuses of this facility.

29 Development of this approach would need careful consultation with lawyers to ensure that a system was devised which would be reasonably proof against successful legal challenge. Notwithstanding sources of supplementary income, we believe that it would be necessary, for legal and practical reasons, to provide arrangements for authorities to be given derogation to spend more than the limit if it appeared justified on the merits of the case. Moreover, widespread requests for derogation could be expected: these would require large numbers of expert staff in the DOE to consider local authority budgets. (Capping of 21 authorities already requires one G5 accountant and 5 middle management staff with their support staff. Widespread capping could require over 100 high quality staff). Criticisms of detailed interference by central government in local budgetting would be inevitable.

c. Limitation of income

30. Another possible route to expenditure limitation would be to remove, except perhaps for a small margin on the lines of paragraph 27 (a) to (d) above, local authorities' power to determine and raise their own income, ie, to confine their income to funds provided by the Government. They would be prevented from spending more than this income. This might comprise simply grant, or in part or whole the yield of a particular tax or taxes (perhaps even a centrally set community charge, as is already done in the case of non-domestic rates). In the latter case, the tax and rates concerned could be defined in statute. The attraction of such an arrangement is that it can appear that the scope for local government spending is ineluctably determined by the yield of the tax - though it would be necessary for the Government to adjust the rate of tax as and when local authorities were required to take on new burdens.

31. Whether or not a tax yield were hypothecated to local government use in this way, it would be necessary for the Government to distribute it between authorities by formula on the lines of the SSAs. This would give rise even more intensively to the kind of problems described in paragraph 26 above, though so long as there was reasonable stability in the income an authority could expect from year to year, there would be no need for derogations.

32. Arrangements on these lines would require a good deal of further study and could not be in place for 1991/92.

D. INCENTIVES TO REDUCE EXPENDITURE

33. It might be possible to use existing statutory powers (those for transitional relief and to give special grants to authorities) to devise a system of incentives to authorities to reduce spending. The Government would prescribe annually benchmark levels of community charge for each authority and if the authority fixed its community charge at less than that benchmark its chargepayers would receive a discount of, say, 25p or 50p for each £ that the actual charge fell below the benchmark. The income foregone by the authority would be met by a special grant from the Government.

34. There are two basic approaches to setting benchmark levels for individual authorities. They might be set by reference to SSA or in relation to the previous year's spending (probably ratcheted down from year to year.) These two approaches might be used in combination. The second approach, related to the previous year's spending would give authorities spending more than SSA some incentive for reductions. But it would be highly controversial with the traditional low spenders who would see it as in effect helping high spenders who have greater room to reduce spending.

35. On the evidence of recent years it is questionable how well authorities would respond to such incentives: they may continue to take the view that the Government's benchmarks were unrealistic and that their electors prefer services to savings. There might well be scope for manipulating budgetting, especially at election time, to secure the discount without achieving any long-term reduction in spending.

E. PENALTIES FOR FAILING TO REDUCE EXPENDITURE

36. A system similar to that described in paragraphs 33 and 34 could be devised, under which expenditure in excess of Government benchmarks would be penalised by withdrawal of grant, thus increasing the proportion of the authority's spending which has to be borne on the community charge. This would be to recreate arrangements similar to those which have been tried and discarded in the 1980s. The effect on chargepayers would be severe: the gearing of the charge already imposes a heavy burden on them if an authority spends at more than SSA, as has been seen this year.

F. INCREASED USE OF SPECIFIC GRANTS

37. If more grant were being put into the system it might be presentationally preferable to put it into particular services rather than general grant. For example, the rates of specific grant for the police and fire services could be increased, or a specific grant given to meet teachers' pay costs. This would be a way of ensuring that the grant was spent in particular ways and might give more control over the level of charge. But this paper concentrates on the use of specific grants as a way of containing expenditure.

To achieve the result intended, it would be essential that the grant should be in the form of a fixed amount or known in advance, rather than an undertaking to meet x% of an authority's spending on a particular service whatever it was. But even then, if the authority is free to spend more on the service than is implied by the amount of grant, such grants may do no more than encourage further spending fully financed by the community chargepayer. If specific grants are not to provide an opportunity for leakage, they must be associated with control of expenditure on the service concerned, e g, through statutorily-imposed expenditure limits or of staff numbers, staff:student ratios, and other resources used in the service. That amounts to central Government's taking responsibility for and control of the function concerned as considered in the next section.

G. REMOVAL OF FUNCTIONS

39. In order to reduce total spending and therefore the amount to be funded by community chargepayers, it would be possible for the Government to take direct responsibility for one or a number of services. This could be done in one of two ways:

- a. the transfer of the function to central government, probably organised on the lines of the health service or the Metropolitan Police; or
- b. leaving responsibility nominally with the local authority but financing the service completely or largely and controlling resource consumption in detail. Under this type of arrangement the authority would remain directly accountable only for efficiency, etc.

40. In principle, it is conceivable to reduce functions so as to reduce the total spending needed to an amount which could comfortably be funded from the community charge alone at a reasonable level everywhere. The logic would be that in these circumstances the level of charge and standard of service could be left between authorities and their chargepayers. For example, an average charge of £200 would yield £7.2 billion in England. This would however imply a major increase in the services controlled by central Government and would be controversial. Moreover, an attempt to confine the functions of local government to services which could be provided at a standard cost per head of population almost everywhere might well be unsuccessful: it is probable that a significant degree of resource equalisation would be needed and the only way in which that can be achieved is by way of a grant mechanism.

41. It would be possible to remove large single services especially those entailing a wide variation between authorities in the cost of providing a standard level of service. This would entail a considerable restructuring of the arrangements for AEF. For example, if education were removed (total cost: £14.8 billion - £415 per chargepayer), it

could probably still be practicable to set a common community charge for providing a standard level of service, provided that the yield of the business rate (approximately £10.5 billion in 1990/91) were no longer hypothecated to local government. If however the aim were to reduce the average charge as a result of the removal of the service, it would be essential not to remove AEF pari passu with the cost of the service: otherwise authorities would have to maintain the existing level of their charges in order to fund the remaining services. But if grant is left behind with the object of reducing the charge, the danger of leakage into higher spending would be very high - ie, the removal of a service or services has very similar implications and problems to those of increasing grant generally as discussed in section A above. The removal of responsibility for large services would undoubtedly be very controversial.

42. Transfer of responsibility for services other than education might be easier, especially those already subject to a high level of specific grant and considerable control by the Government. For example, after specific grants, the police and fire services cost £3 billion - £85 per chargepayer. If these services were transferred and no reduction made in Revenue Support Grant, the average community charge could in principle be reduced almost to the level of CCSS for 1990/91. The possibility of leakage of this extra grant into higher spending would remain high however.

43. Legislation to implement the transfer of responsibility for services would need careful drafting and preparation, requiring the establishment of new structures in central government. The earliest that any changes could be implemented would be April 1992 or April 1993.

III FAIRNESS

44. An important factor in public concern about the community charge is the widespread belief that it is fundamentally unfair because under the flat rate rich people pay the same as poorer people and those who are perceived as having no incomes, e g, non-working wives. This is so despite repeated efforts to get across the fact that community charge benefits are more generous than the rate rebates which they replace; and the fact that the top decile of income pays 15 times more towards local government than the lowest decile.

45. A package of measures designed to improve public acceptability of the charge could include one or more measures aimed to improve fairness.

IMPROVEMENTS TO COMMUNITY CHARGE BENEFITS

a. Improvements to the taper

46. At present if net income exceeds the applicable amount (the level of net earnings which would entitle a person to community charge benefit at 80% of the charge they have to pay), benefit is withdrawn at a rate of 15p for every £ of net income above the applicable amount (an improvement over rate rebates which were withdrawn at 20p in the pound). The extent to which community charge benefit reaches up the income scale depends on the level of the community charge in the area concerned, but in general it does not reach beyond the third decile. If the slope of the taper were reduced still further, say, to 12.5p per £1 or 10p per £1, benefit would reach a little further up the income scale. At present, 8 million people are expected to receive community charge benefit. If the slope were reduced to 10p per £1 a further 2.5 million people would be brought into entitlement to benefit at a cost of £400 million a year, £225 million of which would however go to improved benefits for those already expected to receive benefit. This measure need not be matched for other benefits. It is simple to implement at short notice by way of regulation since it does not require extensive alteration to computer programmes in local authorities.

b. More generous earnings disregard

47. There has been some public concern about the burden of the community charge on young people who are still in training (but not necessarily treated as students for the purpose of the charge) or who have recently entered the labour market and are on low earnings. The position of those who are not students and whose incomes are low could be improved by increasing the earnings disregard for the purpose of calculating entitlement to benefit. Such an increase would reduce the trap which encourages people to stay on income support (giving them full community charge benefit and help with all or most of the remaining 20%) rather than to move into low-paid employment or training where community charge benefit may only meet a small proportion of their charge or none at all. Doubling the earnings disregard to £10 for single people and £20 for couples would bring an additional 460,000 within entitlement at a cost of £80 million. If the improvement had to be extended to housing benefit as well the full cost would be about £250 million a year.

c. Further improvements to the treatment of capital

48. The recent budget removed one objection to the arrangements for community charge benefits by raising from £8,000 to £16,000 the threshold at which ownership of liquid capital excludes individuals and couples from benefit altogether. Concern is being expressed however about the effect on entitlement to benefit of the notional income which is assumed to be earned on capital between £3,000 and £16,000. Such capital is assumed to earn £1 a week for every £250 of

capital above £3,000. This notional income is then added to weekly net earnings for the purpose of applying the taper to decide benefit entitlement in the individual case. It is argued both that the threshold of £3,000 is too low and that the notional income assumed by the tariff is too high. It would be possible to respond to this by raising the threshold or lowering the tariff or a combination of both.

49. If the threshold were increased to £6,000 and the tariff were reduced to £1 per week per £400 of capital, benefit for a pensioner couple with a community charge of £363 and £16000 of capital would be increased by £4 a week. This would cost £80m for community charge benefit, a further £70m if the same improvement were extended to rent rebates and £15m to reduce the tariff for Income Support and Family Credit.

50. These changes are probably all comparatively easy to effect but community charge benefit is a DSS responsibility and they would need to advise on administrative considerations. With the exception of (a), however, they have implications for other parts of the benefit system. All have the disadvantage of increasing the proportion of people dependent on benefits.

B TRANSITIONAL RELIEF

51. The existing scheme of transitional relief is not related to income but in essence to the relationship between the rateable value of the property in which a person is living and the average rateable value for the area. Its purpose is to shelter individuals from large year-to-year increases in bills as a result of the introduction of the charge and as such addresses what is seen as an issue of fairness. The scheme could be improved in a number of ways (including, at the cost of some considerable administrative disruption for local authorities, retrospectively to 1 April 1990):-

a. relief could be maintained at the 1990/91 level for the two subsequent years of the scheme, rather than being withdrawn as now proposed at a rate of £13 a year. This would benefit the 7.5 million people who will be helped by the scheme at a maximum cost in England of £90 million in 1991/92;

b. this years' relief could be increased in line with inflation rather than being withdrawn. This would cost £115 million in 1991/92;

c. the period of withdrawal could be extended to 5 years, thus moderating the very sharp increases that some people will still have to bear after the third year. The maximum cost in 1993/94 would be £150 million and in 1994/95 £100 million.

d. relief could be increased for existing beneficiaries to help those faced with big increases in bills as the area safety net is withdrawn. This might cost £50 million in 1991/92.

e. finally there is one possibility for this year (1990/91): to cover some or all of the difference between actual charges and assumed charges for the purposes of the scheme. If the difference were met in full for those currently getting relief this would give on average an extra £90 to each of the 6.5 million single people and couples included in the scheme and might cost about £500 million.

52. This type of measure has disadvantages: accountability would be eroded to some extent; there would be administrative complexities for local authorities; there is no effect on the RPI; and the more generous the scheme, the more those who do not benefit from it, e.g., because they are first-time payers or because they happen to live in a larger property, may consider that they are not being fairly treated by comparison. Simpler uses of these powers, as proposed in paragraph 13 above and in section C below, may be preferable.

C GRADUATED CHARGES

53. Concern about the fairness of the system might be better met by more comprehensive alteration of the chargepayer's liability depending upon his or her circumstances. Any system which attempts to relate the charge at all precisely to income would be a substantial move towards a local income tax. But a cruder version which would overcome the perceived unfairness of the less well off paying the same as the well off. It might for example be possible to alter liability so that those on higher rate tax pay 1.5 times the charge; those on standard rate tax pay a multiplier of 1; and those not paying tax pay 0.75 or 0.5 of the charge. The increased charge to higher rate tax payers would not fully offset the cost of reduced charges for others, so increased grant would be needed to replace the income foregone. At an average charge of £363, the increased income from higher rate taxpayers would be £300 million and the cost of reduced charges to non-taxpayers would be £700 million. Since community charge benefits would be calculated on the basis of relieved charges, there would be some off-setting savings (of the order of £200m a year).

54. A scheme on these lines would require primary legislation. It would require a scheme to equalise for differences in income and there are other technical issues which would need examination. An alternative route of setting an increase rate of higher rate tax and using the income to offset the cost of reduced charges, might be possible under existing income tax and local government (principally transitional relief) powers.

55. A less radical use of the transitional relief power which might be possible would be to reduce the community charge liability of certain groups of people who are perceived as being harshly treated under the existing system, eg, by reducing somewhat the liability of non-working wives who get no other help because incomes are treated jointly for benefit purposes.

IV OTHER ISSUES

THE STANDARD COMMUNITY CHARGE

56. Consideration is already in hand of the standard community charge which is perceived to be harsh by some types of second home owner. For 1991/92 it is possible to use existing powers either to reduce the maximum multiplier to, say, 1 for all second homes, or for certain types such as those owned by people required by their terms of employment to live elsewhere. The latter would be welcomed by school-teachers, service-people, hospital doctors, some people who work abroad, etc.

STANDARD SPENDING ASSESSMENTS (SSAs)

57. Ministers have undertaken to consider any new evidence on SSAs during this year's round. Official level discussions with the local authority associations have begun although the associations have not yet put forward any evidence or proposals. Ministers are continuing to see MPs and local authorities but little has been put to them yet in terms of substantive evidence. Discussions of SSAs for 1991/92 will need very careful handling, particularly if some of the options in this paper are taken forward.

LEGISLATION

58. Insofar as the possibilities discussed above require primary legislation, most if not all would require consideration in both Houses of Parliament. None of them are straightforward and a great deal of work would be needed to draw up the legislation. The timetable for legislating this session would require tight handling in preparation and drafting and in Parliament where it could have effects on the timing of the session.



CHECKLIST

59. This paper has discussed the following issues:
- I. Additional provision for total spending and AEF (paras 6 to 9);
 - II. Limitation of expenditure:
 - A. Annual elections (paras 10 to 11);
 - B. Containing leakage (paras 12 to 14);
 - C. Direct control of expenditure:
 - a. Conventional chargecapping:
 - (i) in year under current powers (para 16);
 - (ii) in year with strengthened powers (paras 17 to 18);
 - (iii) multi-year capping (paras 19 to 22);
 - b. Comprehensive expenditure limitation (paras 23 to 29);
 - c. Limitation of income (paras 30 to 32);
 - D. Incentives to reduce expenditure (paras 33 to 35);
 - E. Penalties for failing to reduce expenditure (para 36);
 - F. Increased use of specific grants (paras 37 to 38);
 - G. Removal of functions (paras 39 to 43);
 - III. Fairness:
 - A. Improvements to community charge benefit:
 - a. Improvements to the taper (para 46);
 - b. More generous earnings disregard (para 47);
 - c. Treatment of capital (paras 48 to 50);
 - B. Transitional relief (paras 51 to 52);
 - C. Graduated charges (paras 53 to 55);
 - IV. Other issues:
 - The Standard Charge (para 56);
 - SSAs for 1991/92 (para 57);
 - Legislation (para 58).