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SECRET

PRIME MINISTER

COMMUNITY CHARGE

The Chancellor and the Chief Secretary met Mr. Patten and Mr. Portillo today for a further discussion on the community charge. Richard Wilson kindly gave me a brief account of the meeting.

The Chancellor's line is that a way must be found of ensuring that any injection of central Government support is reflected in lower community charges and does not add to local authority spending. The proposal for new cash limits (as described in my minute of yesterday evening attached) seemed to offer the only way forward at present.

Mr. Patten is clearly desperately unhappy at the prospect of cash limits. He has three main arguments against them:

(i) that they are unnecessary and that the community charge discipline will work without them; he is seeking a massive injection (variously estimated at between £2½-5 billion) to keep down community charges;

where from?

(ii) that cash limits would be politically very difficult and that it may not be possible to get the proposal through the backbenches;

(iii) that there would be legal problems, not least in drafting the necessary derogations or powers to hold referendums.

Mr. Portillo takes the line that the Government should introduce no legislation at all. Instead the scope for adjustments should be confined to seeing how far existing powers can be stretched to strengthen the controls over spending. In essence this is Mr. Patten's position also.

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Both the Treasury and DoE Ministers do agree, however, that, if the cash limits idea were to be pursued, it is best combined with some form of referendum to provide the necessary safety valve. This is the one method of combining firm limits on local authority spending, with continued - indeed enhanced - local accountability.

However there was no meeting of minds between Treasury and DoE Ministers and they have agreed to reconvene next Tuesday. In the meantime it is proposed that the paper prepared by officials which describes options (not only the cash limits but also transitional relief and the idea of an extra community charge, set on a national basis for those on high incomes) should be sent to you tomorrow evening. Also urgent advice is being sought from the lawyers on the difficulties of drafting both the provisions on cash limits and the idea of a referendum.

Comment

There remains strong attractions in the cash limit approach if the legal and political problems can be overcome. The idea of a referendum which would focus attention on the single issue of higher spending and higher community charges also has considerable merit.

It may be that Treasury Ministers will support this: but at present there is little indication that DoE Ministers regard this as anything other than the least bad option.

It is also necessary to consider what might be done if the referendum power cannot be implemented in time before 1991-92. One possible way forward would be to announce the intention to go to a system of cash limits and referendum, where authorities wished to exceed those limits; but to accept that it takes time to draft and obtain the necessary statutory powers. For the year ahead i.e. 1991-92 only cash limits would be set in place. From 1992 a referendum power would be added.

I will submit the officials' paper and further briefing from Policy Unit tomorrow evening.

BHP

(BARRY H. POTTER)

10 May 1990

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SECRET AND PERSONAL

PRIME MINISTER

COMMUNITY CHARGE

Work is well advanced on the various ideas for changes to the community charge regime. Draft papers by officials were discussed last week; and some new ideas have emerged (including those put forward by Howard Davies which I have discussed with him). Treasury and DoE Ministers meet tomorrow and will then minute you setting out their proposals.

I will submit the papers along with any guidance notes and advice from the Policy Unit in the weekend box.

Controlling LA Spending

In the meantime, however, you may like to begin considering one key policy issue. Critical to any changes in the community charge must be measures to strengthen control over local authority spending. Only if that is achieved will it be possible to hold down community charges in 1991-92.

As you know, the central proposal is the setting of a cash limit for each of the 107 large authorities.

You will wish to consider how that concept could best be developed in the light of the local authority elections. For, while the pattern that emerged is difficult to analyse, there is at least some evidence that would seem to show accountability is beginning to work. The policy dilemma is to find a means of securing greater certainty of control over LA spending, without damaging or even eliminating (indeed ideally enhancing) local accountability.

Not with the high spending L.A's

Draft Proposals by Officials

There are two critical features to the central proposal: the generation of cash limits; and the exercise of some sanction for exceeding those limits.

The good news is that DoE officials have identified ways to generate the limits. The key features are as follows:

- it would work on local authority expenditure plus changes to balances:

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- it would limit local authorities to this year's spending (as defined above) + an allowance for cost increases (not necessarily the RPI increase) - other adjustments (notably for those spending above SSA);

- it would lead to convergence with SSAs over a period of time.

This is a sensible way forward. The approach is also acceptable to the Treasury. But it is not the generation of these limits that is crucial. Rather it is the sanction which is applied when they are exceeded.

The general approach is that it would be ultra vires for an authority to exceed the limits - in other words councillors who set a budget higher than the limit would be liable for personal surcharge and disqualification. But exceptions to the limits are bound to arise, e.g. to cope with emergency spending.

Two options for safety-valves are then considered:

(i) derogations from the limits to be approved by the Secretary of State;

(ii) an annual referendum to be held if an authority wished to propose a spending level and community charge above the limit.

Assessment-Targets

The general approach is promising: a genuine cash limit on each of the main local authorities which it would be illegal to exceed without derogation or alternatively success in a referendum. It offers very firm control over local authority current spending.

However, it would appear from DOE officials that Mr. Patten is still strongly resistant to this approach. He will argue it amounts to central government controlling nearly 90 per cent of LA spending. And DoE may have led with such a draconian penalty (ultra vires without a derogation) in order to stave off the whole cash limit approach. My impression is that even Treasury officials are wary of making it <u>ultra vires</u> to exceed the limits. I suspect that the Government might also have a little difficulty with some backbenchers, unless the policy is prepared very carefully.

That said, my own view is that the cash limits are necessary. SSAs, even after the promised review, will simply not be achievable for many councils in a short period of time. If the Government is to constrain expenditure, some practical and realistic spending limits have to be created. The difficulty is in devising an effective sanction for exceeding that limit that still leaves room for a meaningful accountability through the "safety-valve".

<u>Assessment - Sanctions under the "safety-valve"</u>
Option (i) in the officials' paper would mean derogation from the limit, that is a higher spending level and hence a higher community charge, at the discretion of the Secretary of State. Even presented as a transitional measure it flies in the face of local accountability. For it would be the Government not the individual local authority, that would be responsible for higher community charges.

Moreover, there would be a difficult policy choice to be faced. If the cash limits were tight, many authorities would apply for derogations: too many derogations would discredit the policy. DOE might therefore argue for reasonably loose targets in order to give the policy credibility - but that could have unacceptable public expenditure consequences. Derogation from the Secretary of State is not consistent with local accountability; and central Government would be capping 90 per cent of local authority spending.

On option (ii) you will have your own views on the desirability of referendums. While it is an idea that has been looked at before and rejected (1981), it does merit further consideration. It is more promising than derogations; critically it offers the one certain means of combining cash limits with local accountability. It would mean that local authorities could only d

exceed the limit if the referendum went in their favour. In short, higher public spending and community charges would be subject to an overt accountability test.

If you are not attracted to referendums as such, an alternative might be to review local authority election procedures. For example, it could be arranged that every year one third of councils (one in each ward rather than one ward in three) were subject to re-election. That would provide an annual test on the local authorities' budget and community charge proposals; again a link could be made to the cash limits.

An additional attraction of this referendum/annual election approach is that capping per se could be dropped. But it could be very difficult to draft the necessary legislation in time: if either a referendum or the annual elections approach were to be pursued, urgent advice on the scale of the legal difficulties needs to be ~~solved.~~ sought.

A Third Option

If you are not attracted to the referendum or annual elections, or it proves impossible to get the necessary legal powers in time, there may be another option which would preserve more local accountability, while nonetheless constraining spending. This would be to use the cash limits in co-ordination with charge capping (and as a variant with small bonuses for the well behaved).

Under this approach, 107 large local authorities would be given cash limits (or targets) at the end of July. The Government would announce that local authorities' spending in relation to this target would be a relevant criterion for charge capping (and any payment of bonuses). Those LAs which set expenditure at or below the target would not be capped (and, if there were bonuses, could qualify). Those setting expenditure above the target would face the likelihood of capping. The precise criteria in relation to the target would not be specified.

The advantages of such an approach include the following:

(i) it sets a realistic and achievable target for each local authority; but the cash targets could still be tough;

(ii) it would not be <u>ultra vires</u> to exceed the cash limit, so preserving technical local government discretion; however

(iii) it leaves accountability in place: and

(a) in practice, almost all local authorities will be anxious to avoid capping and will not push above any guideline figure; those few that do so will have been warned <u>in advance</u> and cannot complain about being capped;

(b) some will use hitting (or doing better than) the target as evidence of good housekeeping and their meriting re-election; (a grant bonus arrangement - at modest cost - would enhance this local accountability);

(iv) it means that over a period of time these guidelines would coalesce towards SSAs; this leaves the original concept in place;

(iv) it is therefore essentially a transitional measure, designed to improve accountability by the creation of more realistic targets, while extending the threat of capping at expenditure levels closer to SSAs (plus bonuses if so agreed).

<u>Conclusion</u>

No particular action is required at this point. But if you think there is merit in pursuing the third approach to sanctions, I could feed these thoughts into Richard Wilson's group.

BHP

(BARRY H. POTTER)

9 May 1990

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