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PRIME MINISTER

THE COMMUNITY CHARGE

with BHW?

We are to meet on 17 May to discuss the community charge. Papers prepared by officials have been circulated under cover of a minute from John Major following his discussions with Norman Lamont, Michael Portillo and myself. John has agreed that it might be helpful if I were to add some comments from the perspective of my department.

The changes which we have made to the local government finance system are of great significance, and are highly controversial, particularly because they have important redistributive effects and there are inevitably many vocal losers. The scale of losses has been exacerbated by the decision of local authorities to spend much more than we planned in deciding total spending and the level of grant last summer and by what many have argued was a relatively tight settlement then. Many people also continue to be troubled about the fairness of the charge as it bears on different groups.

Our aim must be to prevent the community charge from continuing as the dominant political issue: to push it into the background. There is some evidence that the charge is beginning to settle down. It is more widely accepted that everyone should contribute to meeting the costs of local government. Members of Parliament are under rather less pressure. Most on our side favour action to abate some of the effects of the charge rather than another substantial overhaul of the system. It is our present impression that many colleagues explicitly do not wish to see major new legislation.

We must therefore minimise opportunities for controversy and maximise the political advantages which the charge does offer: we have seen in London particularly that prudent authorities can set low charges and that that is welcomed by the electorate. That has not happened elsewhere however this year.



In any year the average level of the community charge is the result of two inter-linked considerations: the level of spending decided on by local authorities; and the level of aggregate external finance which we provide including the yield of the business rate.

The papers prepared by officials focus on legislation to constrain spending by the 100 or more authorities which account for nearly 90% of local government spending in England. I must register my considerable unease about our proceeding down this road for 1991/92 for reasons of principle and practice. We should not underestimate the degree of controversy which the proposal will create among our supporters and more generally, both in Parliament and in the local authorities. It cuts completely across the principle of enhancing local accountability for the level of expenditure through the community charge - its extent would make it different in kind from previous capping systems. It would entail a fundamental change in the position of local authorities and their relationship with central government.

There is also the danger that during the passage of the legislation major amendments will be proposed which we shall not be successful in resisting. Such amendments might prove very expensive for our public expenditure plans. We have already passed the point at which we could be sure that we would be able to complete accurate workable legislation by the end of February for implementation in 1991/92: the kind of arrangements described in the paper by officials are inevitably complicated and there is a significant risk that the system would not work as we intended, and we should be completing the legislation in parallel with authorities' budgetting next winter. Some degree of retrospective application of the legislation would probably be necessary and we can expect that some authorities would not cooperate until they were required by law to do so. For these reasons alone, there would be the risk of challenge in the courts. Some mechanism for allowing authorities to exceed their limits would be necessary: derogations given by the Department would



require considerable skilled resources and would almost certainly be challenged in the courts.

If we think that a system of income limitation is necessary, then we should consider carefully whether the mechanism of derogation should be by way of local referendums rather than administrative action by this department. This approach has many attractions, including that it would preserve local accountability for the level of spending and would much reduce the scope for legal challenge to government.

The difficulties of the income limitation approach need to be set against the possible gain from the system. That depends, of course, on the level of expenditure for which authorities will opt next year. But on the possibly conservative assumption that it will be some 10% above this year's, the system would not deliver savings much more than £0.5 - 0.75 billion more than a somewhat more vigorous application of the existing powers of chargecapping. I doubt whether it is worth the candle.

Were we to conclude that we wanted to move in this direction, I believe that it would be wiser to publish proposals on these lines for consultation later this year, with a view to legislation probably in the first session of a new Parliament. That would give the opportunity for public discussion of proposals for constraining expenditure and for referendums before introducing any legislation for those purposes. If we did that we should need to make it clear in any consultation document that the baseline for such statutory arrangements would be spending in 1990/91 - so that authorities could not position themselves for the new system through their budgets in the years before it came into force. In other words, while I see considerable risks (not least political) in pressing ahead now with legislation, I recognise that there may be a case for advertising this summer the action we would take if local authorities continue to behave irresponsibly. This should inhibit spending up.



Meanwhile, we should seek to maximise the use of existing capping powers to restrain total expenditure, though the number of authorities which can be limited in this way, and the extent of the savings which may result, will depend on the outcome of current proceedings in the courts on the one hand and the level at which Total Standard Spending is pitched next year on the other.

In the absence of limits on spending (and perhaps even with them), there can be no firm guarantee that extra grant will not leak into higher spending. But I am convinced that it will be necessary to have next year levels of Total Standard Spending and Aggregate External Finance which are defensible in terms of the level of community charge which authorities would be capable of achieving as a result. If the settlement is readily defensible, that will allow us to pin the blame on authorities which spend beyond the assumptions in the settlement. We should also be able to argue that there was no reason why well-run, prudent authorities should not be able more or less to hold their charges, or even reduce them, in 1991/92, at least in real terms; and we should be better able to draw a distinction in this respect between most Conservative and Labour authorities.

I recognise of course how tight things are this year on public expenditure. Whatever else we decide to do, there is no doubt that the AEF settlement will be a key part of the effectiveness of the package of measures which we propose to announce. The remainder of the package needs to be seen in relation to it. All this will inevitably have to be considered over the next few weeks in the wider context of public expenditure priorities and other spending bids.

We should not underestimate the political difficulties which flow from the widespread perception that the community charge is unfair in its generosity to those on higher incomes. We have been trying not wholly successfully for the last three years to get across the point that they contribute substantial amounts to local government



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costs through income tax (though we should note that this is truer at the household level rather than the level of the individual). Our arguments have made less impression than we would have liked. For that reason I continue to believe that an extra payment specifically described as a payment towards local government services is desirable. For those on lower incomes, we should be able to agree, without too much difficulty, a modest collection of improvements to the transitional relief scheme. I remain of the view that the improvements to the earnings disregard and the further improvements to the treatment of capital described in the officials' note (Appendix A to Annex C to the Note of 11 May by the Cabinet Office) should be made, rather than the modification to the taper, though I agree that they need to be discussed with Tony Newton.

As to the other detailed criticisms which are made of the operation of the charge, we should bring forward as part of the package detailed changes to the standard charge, taking into account the information which we are now collecting from authorities on the use which they are making this year of their discretion to charge less than the maximum multiplier. Though many of our supporters sympathise with the idea that wives who have no income of their own should not have to pay the charge, I think that any change here would touch too fundamentally on the basic principle of the system. Finally, in my judgement we should look further at the way in which the charge on the one hand and the business rate on the other bear on the occupiers of mixed hereditaments since this is causing a good deal of anxiety to our Parliamentary supporters.

I am sending copies of this minute of Geoffrey Howe, John Major, Norman Lamont, Malcolm Rifkind, David Hunt, Kenneth Baker, Timothy Renton and Sir Robin Butler.

A handwritten signature in dark ink, appearing to be 'CP' with a large, stylized flourish above it.

CP

16 May 1990