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**PRIME MINISTER** 1 June 1990

## COMMUNITY CHARGE REVIEW

There is still a lot of resistance in Whitehall, among Ministers and officials alike, to the idea of new legislation on income limits in time for next year. But frankly the alternative options, based on existing or strengthened capping powers, just don't seem likely to be able to deliver the lower community charges which are your overriding objective.

The options on the table are:

**No Legislation**

1. rely on existing capping powers

**Legislation**

2. enhanced capping powers

3. income limitation: either with derogations granted by DOE
or derogations through referenda
or no derogations at all (at least in year 1)

These options have got to be assessed in terms of their effect on next year's average charge.

On the following page is a table showing some possible scenarios for next year assuming a fairly generous grant settlement (+12%). It is probably unrealistic to expect local authority budgets to rise by less than 10%. Even this takes average charge close to £400. Budget increases of 13%, which many see as a more likely outcome, take average charge (on this grant assumption) to £430. And at this level, as you can see, the RPI impact next May becomes serious.

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## Possible Scenario for 1991/2 - England only

| | 1990/91 actual | 1991/2 estimates | | | |
|---|---|---|---|---|---|
| TSS (£bn) | 32.8 | 36.1 (up 10%) | 36.1 (up 10%) | 36.1 (up 10%) | 36.1 (up 10%) |
| AEF (£bn)[1] | 23.1 | 25.9 (up 12%) | 25.9 (up 12%) | 25.9 (up 12%) | 25.9 (up 12%) |
| LA budgets (£bn) | 36.2 | 39.1 (up 8%) | 39.8 (up 10%) | 40.9 (up 13%) | 41.6 (up 15%) |
| Average CC (£) (after caps) | 357 | 376 | 396 | 427 | 447 |
| RPI impact[2] (published May '91) | (1.4) | 0.2 | 0.5 | 0.9 | 1.2 |
| Expenditure on benefit and transitional relief (£bn) (Great Britain figures) | 2.9 | 3.02 | 3.4 | 3.8 | 4.1 |

**Notes**:

1) assumes an extra £2bn over the baseline ie £3.2bn in all, to cover all local authority-related expenditure. (£400m of this is needed for transitional relief assuming certain improvements to the scheme). Of the remaining £2.8bn available for grant, about £500m is needed for funding safety net and low rateable value area grant.

2) net effect of these figures will be to reduce the effect of this year's 1.4 dropping out of the RPI next year. Assumes a weighting in the index of 0.05 (this year 0.043); it could well be higher given this year's high average charge.

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A reasonable objective of policy might therefore be to have certainty that on average budgets would not increase by more than 10%. Provided there is certainty on this ceiling, there is then room for manoeuvre on providing extra grant to bring down average charge, and above all to ensure that it stays below £400.

Those uneasy about income limits need to convince you that this level of certainty can be achieved through capping. Capping's track record, however, and the considered legal advice about the constraints on tougher capping, entitle you to be extremely sceptical whether it could be sufficient.

There are two major constraints regarding capping:

- The legal advice is that more stringent capping, whether through existing or enhanced powers, is fraught with difficulty. This is basically because of the need to demonstrate 'excessive' spending and the precedent the Government itself has established that this can hardly exist below SSA + 12.5%.

  The legal advice is equally uncompromising even if next year's capping criterion was excessive year-on-year spending increases, and not related to SSAs. In this case, the 'excessive' test would, say the lawyers, require a significant add-on (several percentage points) to a 'reasonable' increase figure. So if the latter was 10%, capping could only come into play above say 14%.

- Second, DOE emphasises that, whatever criteria are chosen, the nature of capping is such that theoretically possible savings are unlikely to be realised in practice. The outcome is likely to be about half of what is theoretically possible. The various figures given in the latest paper to illustrate possible savings from capping, when combined with the caveat as to what is achievable, just do not seem to offer enough to be sure of a sufficient impact on average charge.

Capping has two other distinct disadvantages:

- It is post-hoc. It allows local authorities to keep the initiative by setting high budgets. The Government is left in a responsive role only and open to blame for imposing cuts. That is already happening this year, especially in high-spending authorities not traditionally regarded as 'loony-left'.

- It does not take balances into account. Authorities will be building balances this year. DOE estimates total usuable balances at the end of 1990/91 at up to £1.5bn. Capping imposes no obligation for these to be utilised. Income limits, on the other hand, would positively encourage their use. (But this would be taken into account so as to prevent ~~too~~ higher spending implied)

**The Nature of the Review itself**

This is a further crucial consideration. In your Central Council speech on 31 March you said

> ".... everyone has the right to look to Government and Parliament to protect them as community charge payers from overpowering taxation. They will not look in vain ....."

You will recall the importance you attached to this wording.

This commitment alone surely rules out the first option which is no legislation and reliance on existing capping powers. Without any legislative action, the review will be seen as a damp squib, weighted towards special interest groups such as second home owners, and with only pennies to offer to those most affected by high charges.

(The latter point was the basis of the Daily Mail's highly effective criticism of Mr Heseltine's proposals; viz, that they would be worth only 25p per week to hard-hit chargepayers. That is the amount at stake in deciding not to begin the phasing-out of transitional relief next year).

The next question is whether legislation for enhanced capping is enough of a response to the commitment you gave. At the outset, when an announcement was made in July, it might be. But the acid test would be next year, and the very serious doubts whether it is robust enough to have a meaningful impact on next year's average charge would leave you potentially very exposed if things work out badly.

The real problem is that capping, on whatever basis, provides no certainty that budgets can be constrained at a given level and therefore that extra grant will not feed through to higher spending.

One is thus confronted with the conclusion that the case for income limits is overwhelming, if for no other reason than that it would be seen as a strong response to the commitment you gave, and thus a way of helping you keep the initiative and avoid the charge that your words at Cheltenham were hollow. It is the only item being considered by Ministers which has been kept absolutely secret, and not trailed in the press at all. That, too, will add to its political impact.

There seems to be a real danger that without a major new initiative of this kind the review annoucement will fall far short of expectations among Government supporters.

**PROS AND CONS OF INCOME LIMITS**

The earlier papers from Richard Wilson's group have already concluded that a system of income limits is technically and administratively feasible. What is at issue is the political angle, in particular whether a Bill would get through Parliament, and get through in time.

The political difficulties are undeniable, but they do need to be weighed very bluntly against the advantages:

- a clear ceiling for next year's expenditure, so that extra grant reduces average charge and thus the RPI;

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- putting local authorities on notice now that they need to husband this year's inflated resources to go towards next year's expenditure;

- putting the policy initiative firmly in the Government's hands;

- unequivocal action to meet your Cheltenham commitment;

- ensuring that the much-vaunted review is not just a collection of tit-bits but rather goes to the heart of the matter - local authority overspending;

- **above all, the best way of ensuring that average charge next year is held below 400 and if possible reduced.**

**Derogations** from income limits would need to be kept to the absolute minimum, by being clearly limited to exceptional circumstances (eg where the Government had demonstrably got its grant sums wrong). And to keep average charges and the RPI down, derogations of this kind which were granted would probably have to be funded from grant. To fund them from supplementary community charge would be inviting unnecessary controversy.

But these are second-order issues to be worked up once a decision in principle is taken to proceed with income limits.

**Conclusion**

The key issue for decision next week is whether to go for income limits, or just rely on capping. The other elements of the review- eg on standard charge and transitional relief - need detailed consideration but are secondary and can wait upon the main decision.

Given the need to do everything possible to keep down next year's average charge, the case for income limits rather than capping seems unassailable, and you will be on strong ground in pressing the proponents of capping to try to demonstrate that their option can deliver the kind of average charge you consider essential.

You will also be on very strong ground in arguing the case for a major new initiative as the focal point of the review to be announced next month.

If, however, opinion remains divided, the only way to resolve matters is for the relative merits to be tested quickly against given assumptions and objectives. For example:

| | |
|---|---|
| Objective | : average charge £380 or £400 |
| Assumption | : AEF rises by 12% or 10% |

What capping criteria would be needed to achieve with certainty local authority budgets reconcilable with such figures. What income limits would need to be set to achieve them bearing in mind availability of balances. This approach will at least enable Ministers to focus on some concrete figures.

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