

PRIME MINISTER

24 (a-c)

THE COMMUNITY CHARGE: NEW DEVELOPMENTS

Sir Nicholas Lyell telephoned me at 9pm this evening. He has been discussing the proposed legislation on enhancing capping with the Chancellor and Michael Portillo.

In brief, his view is that the present legislation may be more robust than his officials indicated earlier. In particular, he considers that the criterion of excessive increases year on year might be applied much more vigorously than previously thought.

The argument would run as follows.

- (i) The Government has seen one year of the community charge in operation. The increase in spending is much larger than it would have wished or can be afforded.
- (ii) The Government's intention is that there should now be a standstill in local authority spending in real terms. This would be made clear at an early stage. Correspondingly, any increase which exceeded the standstill in real terms could be deemed excessive.

As you know, 339 out of the 420 local authorities exceeded their SSA this year. But 245 of the 339 were within 0-5% above SSA. Sir Nicholas's line, in arithmetic terms, can be described as follows.

- (a) Assume SSAs in 1990-91 are set at an index number of 100. Then the maximum spending for such authorities this year is 105. If a standstill criterion is then applied allowing say a 10% increase (to represent a standstill in real terms), then, in index terms, spending in 1991-92 should be no higher than 115.5.
- (b) Under the enhanced capping approach, an increase of 10% in SSA would allow local authorities in general to spend 110% in 1991-92. If the enhanced capping criterion was that we would not cap local authority spending up to 5% above SSA that would take spending to an index level of 115.

Sir Nicholas concludes that more vigorous application of existing capping powers is equivalent to the new enhanced capping regime. And it avoids all the political problems of legislation.

I immediately asked Sir Nicholas whether he was sufficiently confident of these findings to pass on these thoughts to you. He confirmed that he was. Sir Nicholas indicated that he thought the charge capping case now before the courts would be won and that the excessive increase criterion (Section 100(b) of the 1988 Local Authority Government Finance Act), can be applied with the vigour described above.

Some very quick thoughts.

First, the numbers need to be examined further.

Second, even if the vigorous capping would have the same effect as the enhanced capping approach, it would not include the referendum provision, which is at the heart of preserving accountability. In that important sense, it is less satisfactory.

Third, it would be posthoc in nature: but an ex ante formula is needed in order to deter higher spending.

Fourth, all previous indications have been that the existing capping legislation is distinctly shaky. Whether this vigorous approach to the excessive increase provision could be applied in practice is of course untested. And if not, the risks of excessive spending and community charges remain unacceptable.

Fifth, this will now of course be taken up by DOE to avoid the legislation option.

Nevertheless, if only as a fallback, it seems sensible for Sir Nicholas to pursue further the possibility of using the existing capping legislation more vigorously than previously planned.

Are you content for him to feed these ideas into the further work now underway?

BHP

BARRY H. POTTER

13 June 1990

A:\economic\community (pmm)

Yes - together
with a vigorous
explanation of why

his previous advice
(in face of count action)
was so restrictive, and

what has changed M.T.