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From the Principal Private Secretary

2 April 1985

I enclose a summary note of the discussion on local government finance at Chequers on Sunday. As you know, the Prime Minister wished this note to be treated in a very restricted way. I am therefore sending one copy to you, one copy to the Chief Secretary's Office, one to Sir Robert Armstrong's Office and one to the Policy Unit here. I should be grateful if no further copies could be made without reference to me.

F E R BUTLER

John Ballard, Esq.,
Department of the Environment.

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LOCAL GOVERNMENT FINANCE

The meeting began with a presentation by Mr. Baker and Mr. Waldegrave.

Mr. Baker said the present system of local government finance had a large number of highly unsatisfactory features: a high, though reducing, level of central government grant with a very complex system of grant assessment; a system of expenditure and rate control which was also complex and often perverse in its effects; local funding from rates 60% of which came from the non-domestic sector who had no direct say in local government elections; the remaining 40% drawn from the domestic ratepayer although full rates were only paid by 12 million of the 35 million local government electors. There had been some success in controlling local government expenditure in recent years, but it had not been complete, and many local authorities and ratepayers were extremely discontented with present arrangements. The lack of local accountability, that is the lack of any strong connection between local expenditure levels and their cost to local voters, was a major cause of the difficulties and any solution must act on this issue.

One set of proposed solutions, broadly "centralist" in character, sought to deal with the problems by having central government take over or pay for major services or cost centres, e.g. education or teachers' salaries. Though these proposals had various advantages and disadvantages, in the end they would fail because they did not change the position so far as the problem of local accountability was concerned. A further possibility was general rate limitation but this too failed to deal with the problem of local accountability: it was also immensely resented by local government and be a huge administrative burden on central government.

Mr. Waldegrave, continuing the presentation, said that Whitehall must be disentangled from detailed control of local affairs. The alternative was great complexity and a system which could be neither explained nor understood. To achieve disentanglement it was necessary to provide a system with adequate and simple disciplines. The key was to establish local accountability by making local voters responsible for local spending while bringing the real costs of services home to local people. This could be achieved by:

- retaining non-domestic rates but charging them at a single nationally set rate, and redistributing the revenue to all authorities on a per capita basis, which would be a proxy for resource equalisation;
- central government grant would still be necessary but would not need to seek to equalise resources; it could concentrate on dealing with differences in need between one authority and another. It should be paid, as in Scotland, as a lump sum;
- abolishing domestic rates and replacing them with a local residents' or community charge, falling equally on all adults in each local area. This would achieve the objective of accountability better than any alternative tax;
- there would need to be rebates for those on low incomes but not such as to insulate them from increases in the community charge by high-spending councils;
- tighter borrowing controls to replace the present insufficiently effective system of capital controls;
- pressure to increase fees and charges where this was reasonable;

- a return to the system of annual elections for local authorities, perhaps one third of the council retiring annually;
- overhaul of the quite inadequate local authority budgeting framework;
- targetted aid to urban areas which would receive insufficient support through the simpler grant system;
- possibly in the longer term a further move to single-tier authorities.

Mr. Ancram explained that while the existing Scottish system was not identical with that in England and Wales, the problems were similar if not yet so severe and had been aggravated by the recent revaluation. Similar solutions were also likely to be appropriate.

In discussion, the following main points were made:

- (a) There was general agreement on the strong case for bringing forward proposals which would deal with the inequities of present arrangements and greatly strengthen local accountability. It was highly desirable to legislate within the lifetime of the present Parliament but it was also most important that proposals should be carefully worked through and that they could be demonstrated convincingly to be a clear improvement on the existing system. Controversy was inevitable and it would be essential to have regard to the forthcoming changes in discussing local authority expenditure in the intervening years.
- (b) Central government also had an unavoidable responsibility for public expenditure as a whole and for taxation and final proposals must take account of this.

- (c) Some of the centralist approaches, especially the proposal to transfer teacher salaries to the Exchequer, would have their exponents and more thought needed to be given to the case against them. The possibility of combining some elements of them with changes on the lines proposed in grant structure and local taxation should not yet be ruled out. But there were real dangers that they would generate further bureaucracies and they did not adequately address the central problems of containing public expenditure and enhancing local accountability.
- (d) The proposal to levy non-domestic or commercial and industrial rates at a single national rate and to redistribute the proceeds on a per capita basis, as a proxy for a resources grant, had many attractions. The existence of a strong rental market made the continuation of a charge on rateable value defensible and logical in this area. The arrangements for keeping valuations up to date would need careful consideration as would the arrangements for setting the rate each year. It was particularly important that there should be considerable stability in the level of the rate from year to year and responsibility for setting the level should lie with central government even though there were some dangers in this course.
- (e) Needs grant would have to continue but the aim should be a very much simpler system, with many fewer factors, than had been developed for the existing grant-related expenditure assessments. The move to a lump sum payment, as was already done in Scotland, would in itself provide a significant incentive to spend at or below the needs level. However, with the much simpler arrangements envisaged for taking account of differences in resources and needs, the problems of low population and high need areas, such as the Northern Isles or the inner cities, would be likely to need some special treatment.

- (f) The case for abolishing domestic rates was a strong one from both a practical and a political viewpoint. The community charge, with which it was proposed to replace them, had the great advantages of simplicity and of significantly strengthening local accountability, although it would also be more difficult and costly to collect. Because of the way in which the local government finance system as a whole would work, marginal changes in expenditure would fall wholly on the community charge and be perceived directly and strongly by electors.
- (g) In England domestic rates raised £4½ billion per annum, equivalent to an average community charge of £140 per head. There would be a substantial number of gainers from the change, but also losers and it would be necessary to consider the impact of change carefully. Transitional arrangements would need to be developed to limit the additional burden on those concerned in the early years. There would also need to be rebate provision for those on low incomes, but everyone should have to find some proportion of the charge for themselves.
- (h) It might be worth considering providing a supplementary source of revenue as well. If so, it was desirable that this should be a tax set locally rather than a revenue assigned by central government. There were in fact considerable difficulties with alternative sources of revenue, in particular many of them would not strengthen local accountability or act as the required discipline on total expenditure.
- (i) Arrangements for compiling the register of those liable to pay the charge, and for enforcement, would be difficult areas which required much further work.

- (j) It was highly desirable to overhaul the local authority budgeting framework and to strengthen arrangements for the control of borrowing. At the same time the arrangements for ensuring that local authorities acted within their powers should be reviewed.

The Prime Minister, summing up the discussion, said that the group were extremely grateful to Mr. Waldegrave, Lord Rothschild and the team of DOE officials for the work that had been done in the studies so far, and for the clear presentation they had had of what were very complex issues. It was increasingly difficult to justify the retention of domestic rates and the group welcomed the proposals which recognised the need to strengthen local accountability and introduce fairer arrangements. With the exception of the proposal on single-tier authorities on which no further work should be done, the proposals should now be developed further by Mr. Waldegrave and his team in the light of the points made in discussion with a view to a further Ministerial discussion in the second half of May. In particular they would then wish to see more detailed proposals on how the community charge would work and be enforced, and on the need for transitional arrangements and rebates for those on low incomes. They would also wish to have more information on the likely overall impact of the changes on typical authorities, individuals and businesses of different kinds. If it was decided to go ahead with proposals for change, the aim should be to publish a predominantly White Paper with some green edges in the early autumn of 1985 with a view to legislation in the 1986/87 session. In the meantime Ministers should say publicly only that progress was being made and that much further work remained to be done. The Secretary of State for the Environment should let the Secretary of State for Scotland have some material for use at the Scottish Conference of the Conservative Party to be held in Perth in early May.

2 April 1985