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CABINET

MINISTERIAL STEERING COMMITTEE ON ECONOMIC STRATEGY

SUB-COMMITTEE ON LOCAL GOVERNMENT FINANCE

LOCAL GOVERNMENT FINANCE STUDIES: INTRODUCTORY AND SPECIFICATION REPORTS

Memorandum by the Secretary of State for the Environment

1. The first phase of the studies is now complete. I attach two reports by Kenneth Baker and William Waldegrave. The Introductory Report provides a compelling analysis of the difficulties we now face with current policies on local government finance. In the Specification Report they put forward for colleagues' consideration a radical package which offers a way out.

2. When we agreed to embark on the local government finance studies last Autumn we did so because we recognised that in both practical and political terms our current policies would not remain viable for more than 3 or 4 years longer. Since then the impactof rating revaluation in Scotland has underlined the unsuitability of rates as an instrument of local taxation.

3. The problem however goes much deeper than rates. In our efforts to rein back the growth of local expenditure, we have erected a system which it is very difficult to reconcile either with our 1979 election objectives or with our Party's traditional approach to local government as part of the dispersal of power within the body politic.

4. A central part of our message to the electorate in 1979 was the need for lower taxation, in order to create a climate in which the private sector could start to recover. This in turn meant a slimmer, more efficient and less expensive sector.

5. An equally important part of our message was the need for less government; less of the Whitehall nannying which had been the hallmark of our socialist predecessors; less intervention and regulation of the lives of local people; and less central control of local government. We wanted to restore, in the words of the 1979 manifesto "that self-reliance and self-confidence which are the basis of personal responsibility and national success."

6. Quite rightly, our determination to reduce the scale of public expenditure and the attendant tax burden has encompassed local as well as central government. And we have had some success - although not as much as we would have wished - in reining back the growth in local government spending and manpowe which seemed so relentless in the 1960s and 1970s.

7. But the measures we have adopted in pursuit of lower local authority expenditure and rates have meant neither less interference from central government nor greater individual choice. As each measure proved less effective than we had hoped we have been driven to adopt even tougher pressures, with the result that we are now enmeshed in the detailed affairs of local authorities in a way which we never contemplated in 1979. And although we are doing this ostensibly in order to protect the individual citizen, we increasingly look to him like the man from Whitehall who thinks he knows best.

8. We are as a Government consequently portrayed as hostile, not only to the institution of local government, but also to the reasonable exercise of local choice and local democratic self-determination - an accusation we have in the past levelled convincingly against our political opponents. We have alienated a great many of our supporters in local government. And increasingly the moderates in the Labour Party who have co-operated in securing our objectives are being squeezed out by the extremists of the far left who prefer confrontation with central government. Although we win some of our battles each year, the war intensifies.

9. We find ourselves in these difficulties because our policies assumed too optimistically that if we increased the pressures to economise, the accountability of authorities to their rate-payers would be bound to deliver lower expenditure and rates. But as accountability failed adequately to deliver we were compelled to tighten the screws still further. Our optimism was misplaced, however, not because local people do not believe in lower public expenditure and taxation - it is after all what they voted for in 1979 and 1983 - but because the current local government finance system obscures accountability so that the electorate do not know who to blame. The link between those who use, those who vote and those who pay for local services is in many areas so attenuated that accountability has well nigh disappeared.

10. We must of course stick to our objective of reducing the burden which the public sector - whether central or local government - imposes on the taxpayer. But we cannot continue to achieve it by overriding the views and preferences of local people by extending our existing local government policies in the direction of still more central control from Whitehall. That would be wholly alien to our philosophy.

11. We should instead seek to clarify and sharpen the accountability of local authorities to local people and to strengthen the links between those who use, vote and pay for local services. Local electorates may vote for the standard of service of their choice, but if they do, they must pay for it, and perceive clearly that they will pay for it.

12. This is the approach advocated in the two reports. Colleagues will want to consider and debate the pros and cons of that approach. I am in no doubt that a framework of effective electoral and financial accountability is the only way to combine local decision-making with responsible budgeting. Not for the first time in our Party's history the way ahead will be to "trust the people".

PJ

Department of the Environment
2 Marsham Street
SW1

14 May 1985

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The Local Government Finance Studies

Introductory Report

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The Local Government Finance Studies

Introductory Report

An appraisal of current local government finance policies and the relationship between those who finance, use and vote for local services.

Presented to
the Ministerial Steering Committee
on Economic Strategy
Sub-committee on Local Government Finance
by the Minister for Local Government
and the Parliamentary Under Secretary of State,
Department of the Environment

May 1985

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Introduction

1 In October 1984 Cabinet agreed that a series of studies of the local government finance system should be set in hand as a matter of urgency. They did so because they considered that the existing system was under severe strain; and that present policies — notwithstanding some success in reining back local authority spending — could not hold the position far into the next Parliament.

2 The Secretary of State for the Environment announced the studies at the Conservative Party Conference later that month. They were to be conducted by the Minister for Local Government and Mr Waldegrave. They would be looking at the entire system of local government finance, focussing in particular on the distribution of rate support grant, the balance between exchequer and local funding of council spending, measures for improving local authority accountability to their electorates and how local revenues might best be raised, whether from domestic or business ratepayers.

3 In November, Ministers discussed at E(LF) the arrangements for conducting the studies. They agreed that the first phase should be conducted within the Department of the Environment, supported by a number of outside advisers, with informal consultation with other departments as necessary. The first phase was to be concluded with a report to E(LF) at Easter, exposing issues and presenting initial proposals for Ministerial consideration. The Committee would then give guidance on further work to develop detailed proposals with a view to their eventual publication for consultation. These detailed proposals were to be presented for consideration by E(LF) in November 1985, in order to keep open the possibility of legislation in the present Parliament.

4 Department of the Environment ministers gave an informal presentation to the Prime Minister on the studies' progress shortly before Easter. This report provides a formal presentation of the studies' initial findings and conclusions at the end of the first phase; and sets out the principal components of the proposals for reforming the local government finance system.

Chapter 1: The Background: Local Authorities and Government Policy Since 1979

1.1 Since its election in 1979 two of the Government's principal objectives have dominated its relations with local government. The first was the Government's desire to lift the burden of detailed central control off local government and to encourage where possible local government to lift unnecessary controls off the backs of citizens and business. As Michael Heseltine promised in 1978:

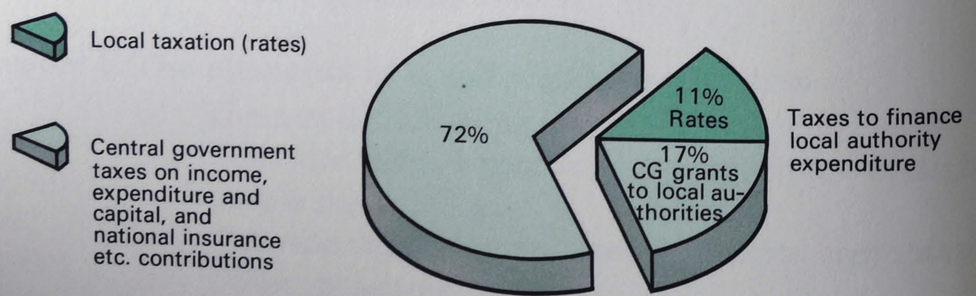
> "We are committed to a root and branch appraisal of the powers of Whitehall over local government. We shall . . . reduce and eliminate many of the controls that currently tie Britain's cities to the Whitehall departments. I believe that that will speed decisions, save money and restore a sense of competitive independence to local democracy"

The second, central to the Government's economic policy, has been the attempt to secure a sustained reduction in the size of the public sector and in the level of public expenditure. Both were seen as part of a co-ordinated policy of increasing national efficiency and of creating the financial and social background for sustained economic recovery.

1.2 The Government's initial legislative and administrative effort gave equal weight to the two aspects of the policy. A large number of unnecessary detailed controls over local government which sought to establish Whitehall's responsibility for matters which lay properly within the ambit of local decision were abolished. Unified block grant, introduced in the Local Government Planning and Land Act of 1980, sought to increase the costs for authorities spending far above average, while leaving them free to determine their spending levels on the basis that they would answer to their electorates for the costs involved.

1.3 Inevitably, however, central government's priorities have shifted to dealing with the problem of the level of local government spending. This was understandable. Local government in the United Kingdom is a major part of the public sector. It employs over one and a half million full-time and nearly a million part-time employees. Its current and capital expenditure account for a quarter of all public expenditure and 10½% of the Gross Domestic Product. It is therefore responsible for a significant proportion of the tax burden borne by individuals, industry, business and commerce, either nationally through government grants or locally through rates, as figure 1 shows.

Figure 1 : LOCAL AUTHORITIES' CLAIM ON THE TOTAL TAX BURDEN — UNITED KINGDOM



1.4 The Government had taken the view from the outset that its objective of reducing public expenditure and taxation should apply as much to local authorities as to central government. In doing so, however, it was seeking to reverse a trend of growth and expansion which had continued virtually uninterrupted since the end of the last war. In the 1960's and 1970's the volume of local government current expenditure and its manpower each grew by about 3½% a year in England. In the 1970's the growth was about 3% and 1¾% respectively, as figures 2 and 3 illustrate.

Figure 2 :
AVERAGE ANNUAL GROWTH IN LOCAL AUTHORITY CURRENT EXPENDITURE

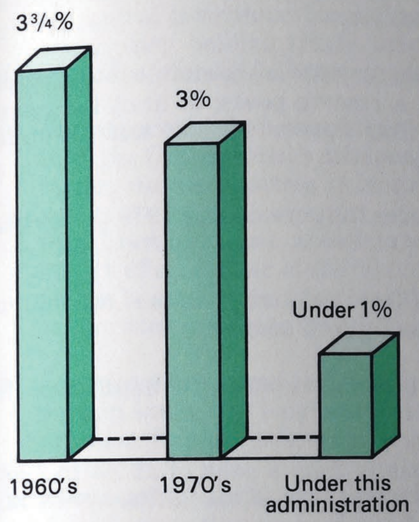
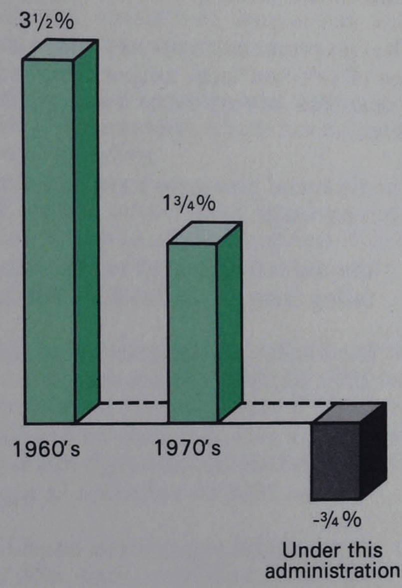


Figure 3 :
AVERAGE ANNUAL CHANGE IN LOCAL AUTHORITY MANPOWER — ENGLAND



1.5 It became increasingly clear that none of the mechanisms available in the past nor even the new block grant pressures would easily slow down this growth. The Government therefore found it necessary to impose a series of external pressures of ever-increasing toughness on local government. The measures adopted in England were:

(i) reductions in the total amount of grant distributed to local authorities; since 1978/79, the percentage of planned expenditure met by grant has been reduced from 61% to 49%;

(ii) the block grant system altered the basis of distributing rate support grant, so as to reduce the proportion of an authority's expenditure met by grant if it spent significantly above its grant-related expenditure (GRE) — the level of spending assessed by the Government to provide an average standard of service.

(iii) the block grant system was further supplemented by a system of expenditure targets designed to secure year-on-year reductions; authorities which spent above their targets suffered grant penalties;

(iv) The new Audit Commission was established to encourage a keener search for improved value for money by local government;

(v) from 1981/82 the Government for the first time sought to control the local authorities' net capital expenditure;

(vi) rate limitation.

1.6 The implicit assumption of the first three of these measures was that authorities, when faced with reductions in grant, would make corresponding reductions in their expenditure rather than risk courting electoral unpopularity by covering the grant losses with corresponding rate increases. This basic assumption has turned out to be flawed, however; and particularly so in a minority of councils, which have not only failed to reduce their expenditure but have increased it substantially in real terms, with correspondingly high rate increases.

1.7 In 1983/84 local government's budgeted expenditure exceeded the Government's targets by £770 million, 75% of which was accounted for by the expenditure of the top 16 overspending local authorities. A similar pattern occurred in 1984/85 when 75% of a planned overspend of £850 million was attributable to 12 authorities. Though some of the total overspend may derive from optimistic figures in the public expenditure White Papers, it is clear that at least for an important minority of authorities accountability was simply not operating in the way Government had hoped and so the grant pressures were proving ineffective.

1.8 The Government's response was to introduce statutory powers to enable it to limit directly the rates of selected local authorities, backed up by a reserve power to limit the rates of all authorities. The powers have been applied for the first time in 1985/86 and affect 18 local authorities.

1.9 The financial pressures have had some success over the period since 1979 in slowing down expenditure growth:

(i) the annual rate of growth in the volume of local authority current expenditure has fallen from 3% in the 1970's to under 1%, as figure 2 shows;

(ii) local authority manpower has fallen by ¾% a year, a cumulative reduction of 5% since 1979, as figure 3 shows;

(iii) average rate increases have fallen substantially from a peak of 22.7% in 1980/81 to 5.5% in 1984/85,(although this is principally a reflection of the fall in overall inflation, and the 1985/86 reduction in aggregate exchequer grant will reverse that trend).

(iv) gross capital expenditure has fallen by about 20% in cost terms between 1979/80 and 1984/85. In addition, some £10 billion of local authority assets have been sold.

1.10 Compared with the trends of the 1960's and 1970's these results represent an achievement. But it is a relatively modest achievement. The fact remains that local authority current expenditure is still growing, albeit at a slower rate than before, and as a proportion of GDP it is now higher than it was in 1979/80. The Government has had to revise its public expenditure plans upwards every year to take account of existing spending levels. Local government in England is in 1985/86 planning to spend about £1.8 billion more than was originally planned for that year in the Government's public expenditure plans published in 1983. The reductions in local authority manpower are very modest compared with what has been achieved elsewhere in the public sector (15% since 1979 in the Civil Service, for example) and the total has been more or less static over the past eighteen months. On capital expenditure, big underspends in 1981/82 and 1982/83 were followed by large overspends on the cash limit in 1983/84 and 1984/85, despite a request for restraint in July 1984.

1.11 Meanwhile, by imposing increasing external pressures on institutions jealous of their democratically-elected status (institutions with in many cases a natural propensity to expand) the Government has faced conflict with local authorities. That was inevitable. It has meant, however, the near abandonment of the other leg of the original policy — the restoration of independence to local government in its own proper sphere. That was perhaps a necessary price to pay in pursuit of the overriding aim of expenditure restraint. What is becoming clearer now is that the policy of expenditure restraint is itself in increasing danger as the financial weapons so far employed become increasingly blunted by use. In particular:

(i) the rate support grant distribution system with targets and holdback has become increasingly complex, both for central government to operate and for local authorities in terms of managing their finances effectively, while the grant paid to individual authorities has fluctuated considerably from year to year. Authorities have in response to targets and holdback adopted creative accounting techniques in order to maximise their eligibility for grant. At the same time the policy of cuts in the overall percentage in aggregate exchequer grant aimed at advancing both the original policies of expenditure restraint and restoration of local responsibility has shifted more of the burden of paying for local services from the national to the local tax payer. As a result of all these factors the ratepayer has little idea of how his rate bill relates to the spending decisions of his council, and it is becoming ever easier for councils to persuade their voters that central government carries the blame for increased local rates.

(ii) the system of expenditure targets and grant holdback has alienated most of central government's lower-spending allies in local government, who accept neither the need for central government to set their targets nor the basis on which they are set — a basis which they believe treats them arbitrarily and unfairly in comparison with high spenders, since it is based on past spending patterns.

(iii) the measures taken to reduce overspending on capital have aroused strong opposition from the Government's own supporters in local government, which has not been offset by any marked success in controlling the overspending.

(iv) rate limitation has necessitated detailed central government involvement in the affairs of a number of individual authorities, which is administratively difficult and makes heavy demands on resources; it has also led to direct confrontation with certain authorities involving political and legal brinkmanship.

(v) both grant pressures and rate limitation may have helped foster political extremism in certain inner city local authorities; such authorities are using the present local government finance policies as a pretext for promoting the ideologies of class conflict.

These problems point to an increasingly heavy price in the future for relatively modest gains.

Chapter 2: The case for reform

2.1 In political terms, if we continue to try to apply existing policies within the present financial framework we will, in effect, be declaring the modern equivalent of a hundred years war on local government. But in any event, those policies have in practical terms only a limited life expectancy. Of the external pressure mechanisms, targets are proving so difficult to justify and to operate in any sensible or equitable way that their demise is only a matter of time. In the short term the pressure for restraint imposed by targets and holdback can be replaced by grant pressure using grant mechanisms under existing powers. But such mechanisms can only be used for a few years before they become ineffective or their effects become politically unacceptable. Rate limitation is working reasonably well in the first year of its operation. But it cannot be expected to serve as a permanent, long-term mechanism for constraining the generality of local authority expenditure.

2.2 The key point is that experience has shown that with the present rating system we cannot rely on the accountability of authorities to their ratepayers to secure expenditure restraint. And those parts of our present mechanisms (ie block grant reductions, targets and penalties) which rely for their effectiveness on voter reaction to increased rates have brought into even starker focus the inadequacies of rates as a source of local accountability.

2.3 On the capital side the present control system has fallen into disarray, largely because of the success of the policy of sales of local authority assets. Local authorities have accumulated £5 billion of capital receipts from those sales, which they would like to use to supplement capital spending allocations to meet what they see as urgent needs. But in the interests of macro-economic management we have had to ration the rate at which they can spend these receipts by reducing the "prescribed proportion" of receipts which they may spend in one year to 20% for housing receipts and 30% for other receipts. This has proved highly unpopular with authorities of all political persuasions, and avoidance devices are multiplying.

(i) The Grant System.

(a) Targets and holdback.

2.4 E(LA) have agreed that it would be highly desirable to abandon targets and holdback for 1986/87 for a number of reasons. In particular targets have caused considerable resentment and a sense of grievance among relatively low spending authorities which would otherwise be allies of the Government. These are authorities which have been set targets, related to their past spending, below the level of their GRE. Thirty eight of the thirty nine non-metropolitan counties are in this position. They cannot understand why they are being obliged, under pain of severe grant penalties, to spend below a level of expenditure assessed by Government as constituting a standard level of service, while other high-spending authorities are set targets well above their GRE. Figures 4 and 5 give an indication of the problem.

2.5 Other objections to targets are that they are inflexible, being based on general principles, which makes it increasingly difficult to devise equitable spending figures for over 400 individual authorities; that they override and undermine the basic block grant system; that they interact with rate limitation in a way which requires rate limits to be higher than they otherwise need be in order to finance grant penalties levied by the Exchequer; that they will become very difficult to operate in the wake of the abolition of GLC and the metropolitan counties, most of whose service responsibilities are to be divided up between the London boroughs and metropolitan districts; and that targets are only effective if holdback is made more severe each year, yet holdback cannot reasonably be made even harsher than the 1985/86 scheme, particularly given the inevitably rough justice underlying the targets.

2.6 The political and practical pressures to abandon such a system are strong indeed.

Figure 4 :
TARGETS AS A PROPORTION OF GRE

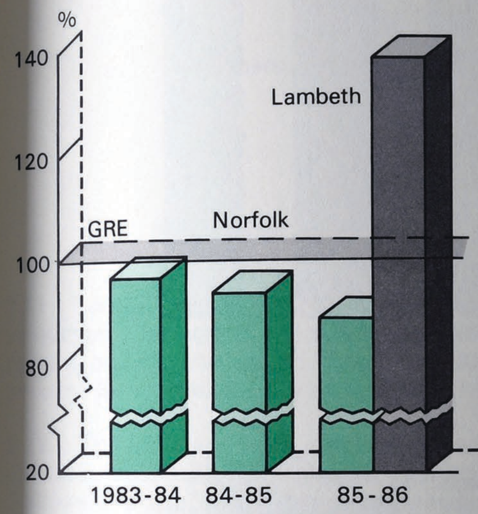
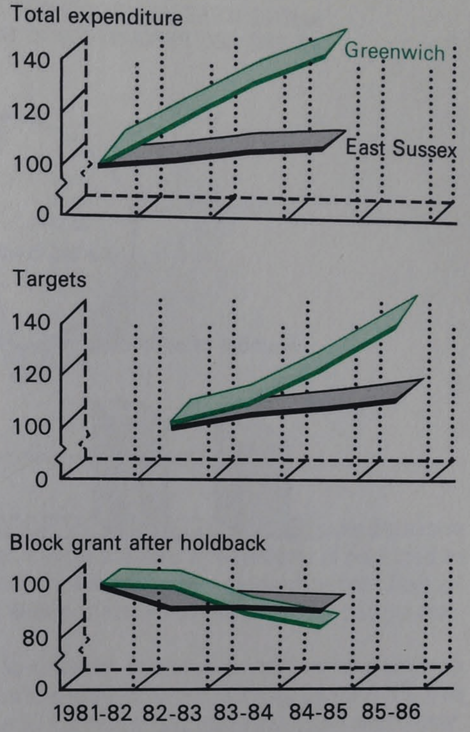


Figure 5 :



(b) Grant pressures

2.7 The abandonment of targets will require other measures to sustain pressure for spending restraint. Reductions in aggregate exchequer grant and a stiffening of the disincentives to increased spending incorporated in the block grant system are the main options. Grant pressure should be effective in the short term — perhaps the next two to three years — but thereafter becomes self-defeating. For both reductions in the level of aggregate exchequer grant and steepening of the block grant taper (to make the cost of marginal increases in spending higher to local ratepayers) have the effect of driving an increasing number of authorities out of grant altogether. They are then immune from the pressures of the grant system and the cost of marginal increases in expenditure actually diminishes for their rate payers. Figure 6 shows the number of authorities which are driven out of grant if the level of aggregate exchequer grant continues to be reduced on present trends from its 1984/85 level of 52% to 38% by 1990/91. If, in addition to reductions in aggregate exchequer grant, the slope of the block grant schedule is doubled, the group of authorities driven out of grant changes to include a number of high spending local authorities, such as Tower Hamlets, Newcastle, Lambeth, Basildon, Thamesdown and Southwark. It might be possible to rate limit all the high spenders pushed out of grant to maintain pressure on them; but it would not be possible to select the low spenders in the same position.

(ii) Rate limitation

2.8 Rate limitation has so far worked well in the first year of operation. But the Department of the Environment has been fully stretched in handling the 18 authorities selected. If further expenditure reductions are required more authorities would need to be selected; and for significant reductions to be achieved a very large number of authorities would need to be selected, as figure 7 indicates. These are much larger numbers than the Department could realistically cope with and would expand the selective scheme beyond what it was designed to achieve.

Figure 6 :
AUTHORITIES WHICH GO OUT OF GRANT AS THE AEG PERCENTAGE IS REDUCED

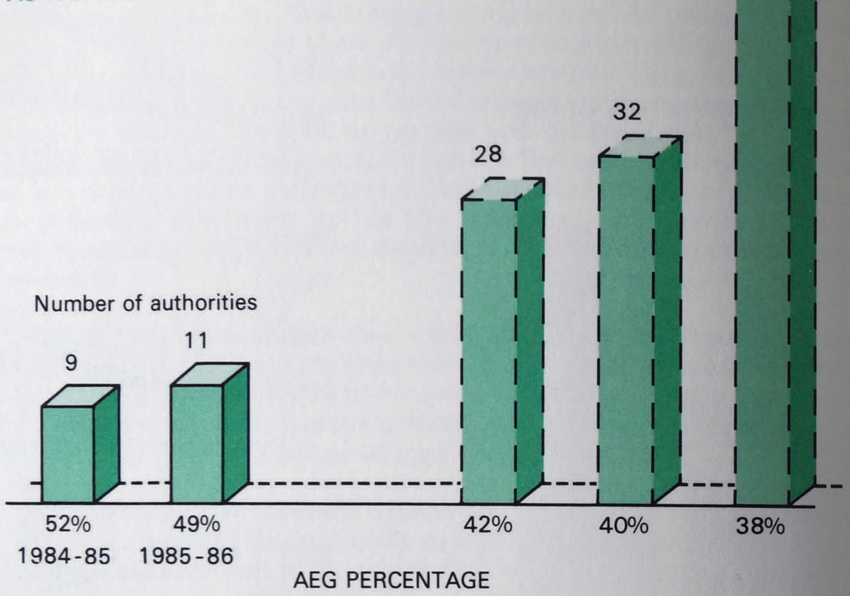
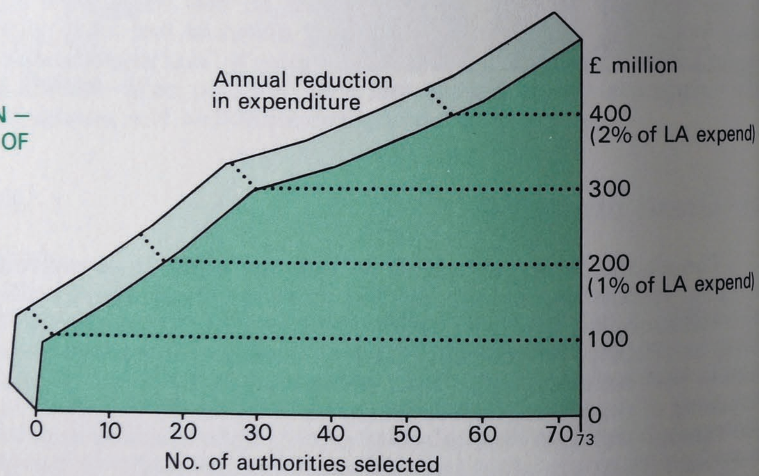


Figure 7:
RATE LIMITATION – THE HIGH PRICE OF SIGNIFICANT REDUCTIONS



The chart assumes that each authority selected reduces its expenditure by 5% per annum in real terms

(iii) Rates

(a) Not enough voters pay

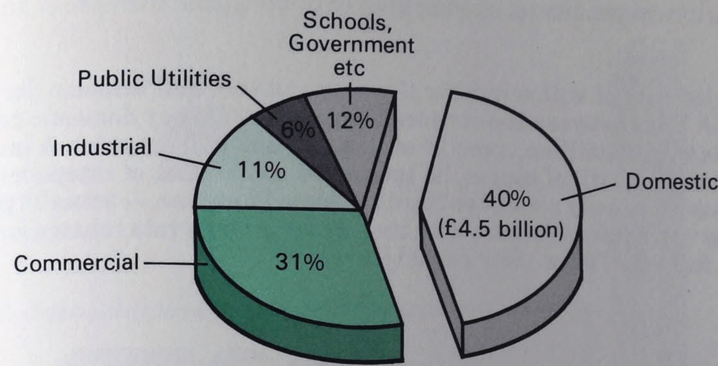
2.9 The attempt to rely on the accountability of councils to their ratepayers as a means of securing expenditure constraint has shown clearly the weak linkages between those who pay for, vote for and use local authority services. In particular it has highlighted two major flaws in rates as a tax on which to rely exclusively for the stimulation of voter reaction:

(i) local authorities derive more than half their rate income from the non-domestic sector which has no vote;

(ii) of those who do have the vote, only about a third directly pay full rates.

2.10 As figure 8 shows, 60% of the rate income of local authorities in England comes from the non-domestic sector, which includes commerce, industry, public utilities and other public buildings. In 1984/85 this sector yielded £6.5 billion in rate income. The remaining 40% — £4.5 billion (after rate rebates) — came from domestic ratepayers.

Figure 8 : RATE INCOME IN ENGLAND 1984–85



Rate income (net of domestic rate relief grant and rate rebates) £11 billion

2.11 Local Authorities are thus able to tap more or less at will the unrepresented non-domestic ratepayer, who has no effective sanction over the level of expenditure to which he is required to make a hefty contribution. And his contribution in turn substantially reduces the cost both of average levels of expenditure and marginal increases in expenditure to the *domestic* ratepayer.

2.12 The effects of such a situation can be seen at their most extreme in authorities such as Camden, where the non-domestic sector provides 75% of the authority's total rate income. Figure 9 shows how the Kodak company, which has premises in Camden, has suffered as a result: over the last five years its rate bill has gone up twice as fast as inflation.

Figure 9 :
RATE BILL OF KODAK PREMISES IN CAMDEN (RV £445,000)

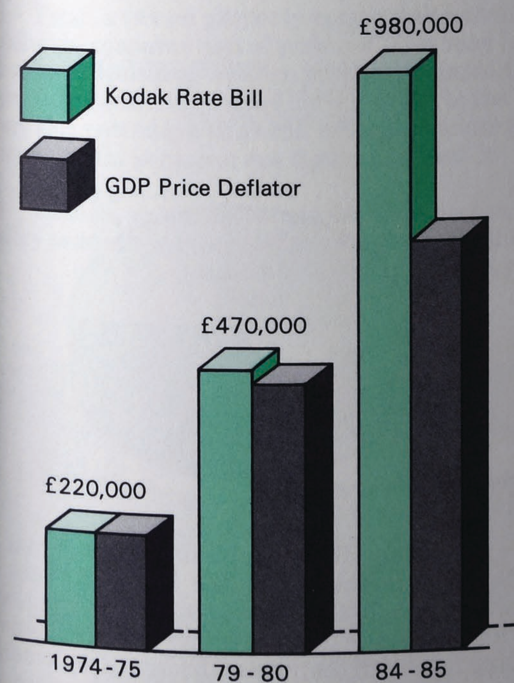
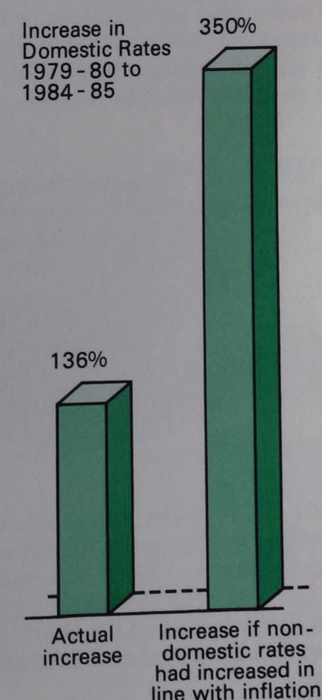


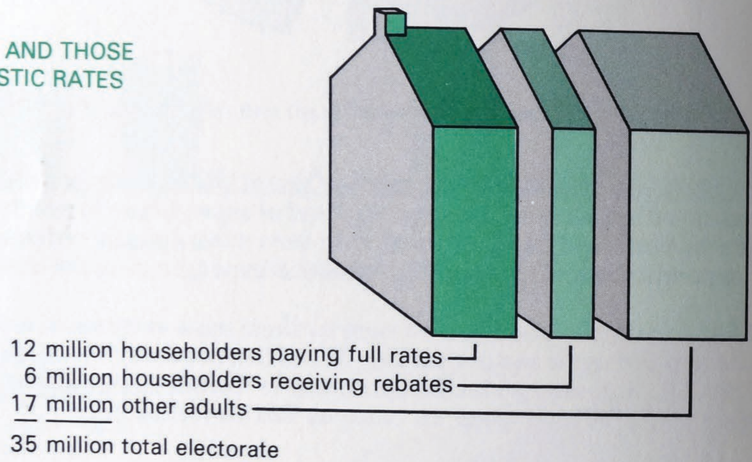
Figure 10 :
EFFECT OF INDEX LINKING NON–DOMESTIC POUNDAGE FROM 1979–80:CAMDEN



2.13 If, however, Camden's non-domestic rate poundage had been tied to the rate of inflation over the last five years, the domestic rate poundage would have had to increase by 350% to finance the authority's expenditure, as compared with the actual increase of 136%, as figure 10 shows.

2.14 The accountability of authorities for their expenditure and taxation decisions is further eroded by the weak links between the electorate and those who pay domestic rates. Of the total electorate in England of 35 million, some 18 million are liable to pay rates. A large proportion of the remaining 17 million will of course, be spouses or co-habitees of ratepayers. But of the 18 million liable to pay rates, only about two thirds — some 12 million — actually pay their rates in full; 3 million receive partial assistance with their rates through rate rebates and the remaining 3 million receive full relief from their rates bill.

Figure 11:
THE ELECTORATE AND THOSE WHO PAY DOMESTIC RATES



2.15 These figures are national averages. They disguise some significant variations between individual authorities. In Hackney, for example, the position is more marked: only about half of ratepayers — a quarter of the electorate — are paying full rates, as figures 12 and 13 show.

Figure 12 :
HACKNEY – PERCENTAGE OF DOMESTIC RATEPAYERS PAYING FULL RATES

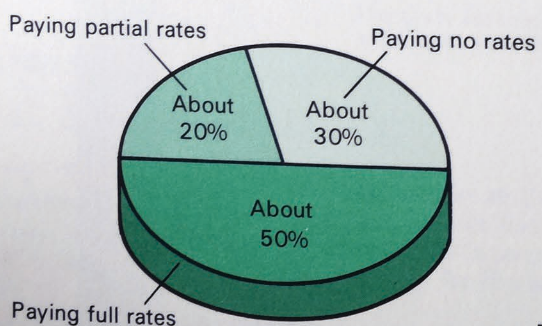
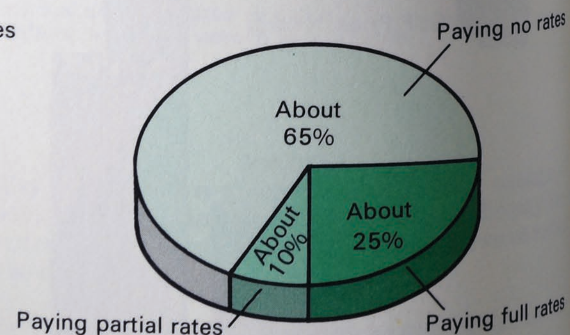
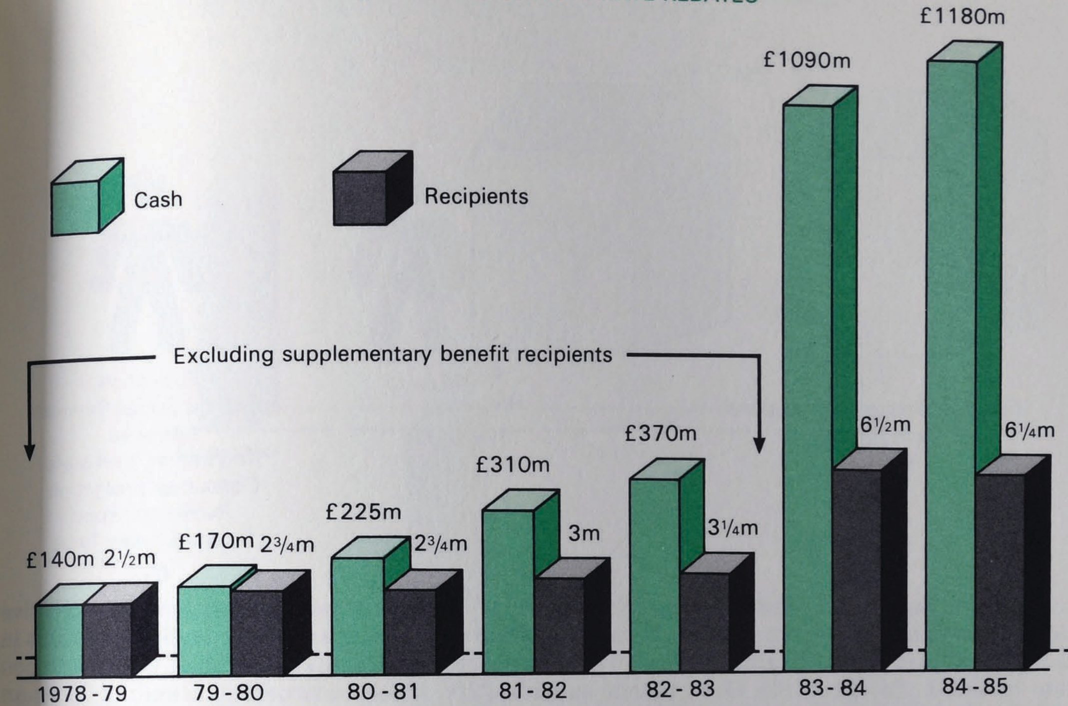


Figure 13 :
HACKNEY – PERCENTAGE OF ELECTORATE PAYING FULL RATES



2.16 The growth in rate rebates has therefore been a significant factor in weakening the link between voters and ratepayers. Figure 14 shows the pattern over the last five years. The dramatic leap in 1983/84 is explained by the introduction of the housing benefit scheme, which for the first time brought together those receiving assistance under the rate rebate scheme (the first five columns on the chart) and those receiving help with their rates through supplementary benefit, where separate data relating to assistance with rate bills had previously been unavailable.

Figure 14 : GROWTH IN RATE REBATES



(b) Confusing signals to those who do pay

2.17 There is nothing intrinsically wrong with taxing property, any more than any other commodity. And rates have many virtues and advantages which have long been recognised, a fact which was acknowledged by the Government in its 1983 White Paper "Rates"(Cmnd 9008). But if our main and overriding concern is with what a local tax tells those who pay it about the cost and level of the services they consume, then changes in rates are not a good guide for the taxpayer.

2.18 First, a tax on property cannot take account of the composition of households and thus of households' consumption of services. This may have been less of a problem in the past, when the bulk of local spending went on property-related services. Before the war a much larger proportion of municipal activity related, for example, to the provision of utilities, such as gas, electricity and water. But nowadays the bulk of local spending is on services to people, such as education and personal social services; see figures 15 and 16.

2.19 Second, rateable values for similar properties vary substantially from one part of the country to another, because they are based (in theory) on market rental values. As a quite explicit

Figure 15 : HOUSEHOLD COMPOSITION – SOME EXAMPLES

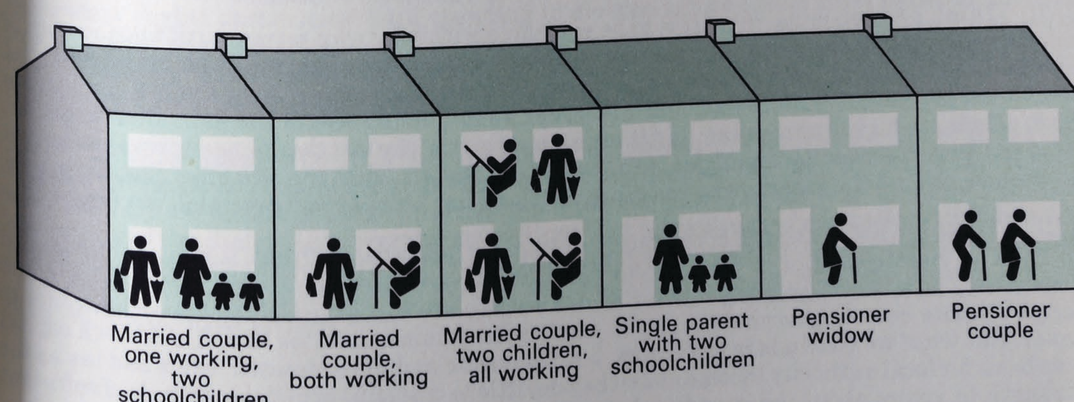
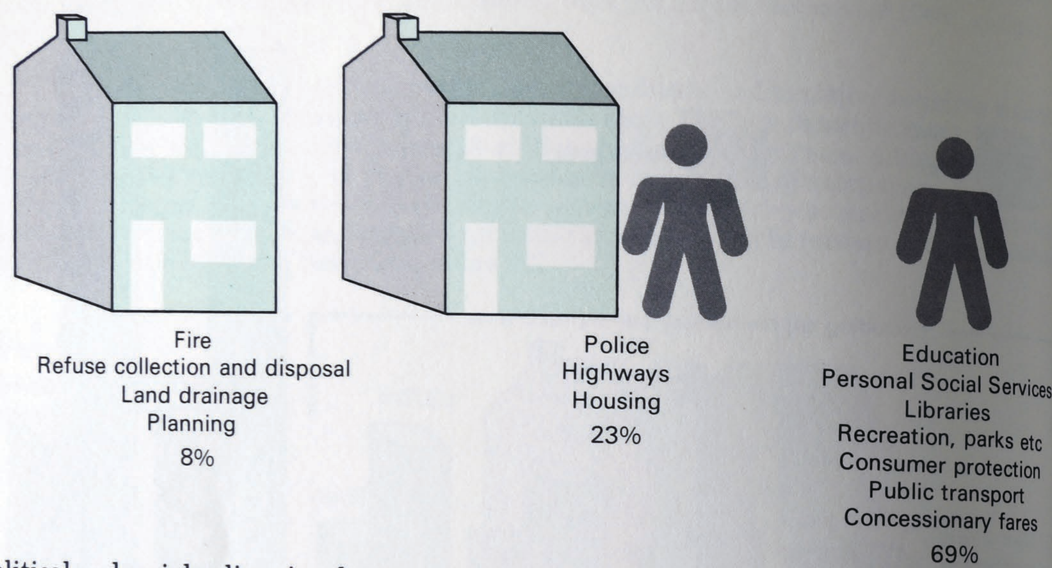


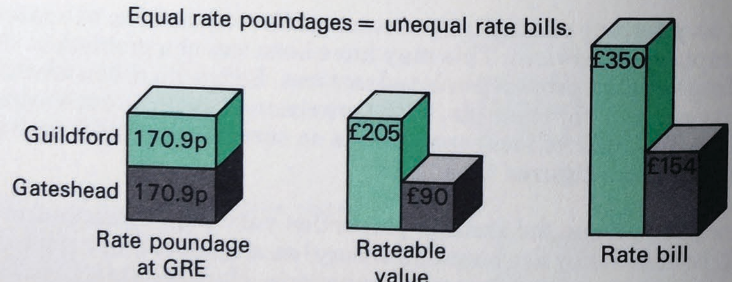
Figure 16: PROPERTY-RELATED AND PEOPLE-RELATED SERVICES AS A PERCENTAGE OF LOCAL AUTHORITY EXPENDITURE



political and social policy aimed at ensuring comparable levels of service nationwide, successive Governments have distributed grant between authorities to compensate them for variations in rateable value so that local authorities can finance comparable levels of spending with a common rate in the £. In effect, the Government subsidises local expenditure by standing in as an additional ratepayer in each area. The consequences for individual ratepayers, however, are extremely varied. Someone living in a 3-bed terraced house in the home counties where rateable values are high not only pays a greater proportion of his income in housing costs, but also pays a much higher rate bill for the same level of service than his colleague in a similar house in the North East, where prices for equivalent houses are cheaper and hence assessed rental values are likely to be lower; see figure 17.

Figure 17: ILLUSTRATIVE RATE BILLS FOR A THREE BEDROOM TERRACED HOUSE FOR AN EQUIVALENT LEVEL OF SERVICE

Equal rate poundages = unequal rate bills.



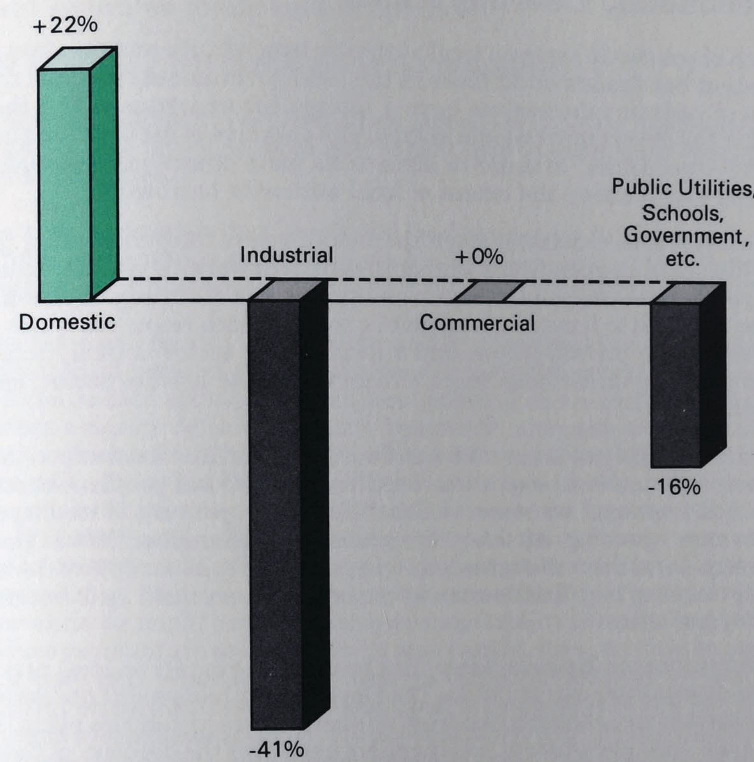
You Pay 127% more in Guildford

2.20 Third, a tax on property, if it is to be equitable within its own terms, must take account of relative changes in the value of different properties (however that might be measured). Yet revaluations taken at intervals can and do produce dramatic changes in the tax liability on individual properties, with consequential disruption to the finances of the individual taxpayer. Such effects are highly unpopular; and it is no surprise that the last two domestic revaluations in England were followed by enquiries into the Rating System, that the two after that have been postponed, or that the recent revaluation in Scotland has been so controversial; see figure 18.

2.21 These are not criticisms of the rating system for failing to do things it was never intended to do. The characteristics of the system described above have their own internal logic and consistency as a tax on property. As far as our studies are concerned, it is outside our remit to judge whether central government might want to keep domestic rates as one of its own capital taxes. But what we conclude is that rates, both domestic and non-domestic, are a bad tax as the sole basis for local authority income, since they do little to transmit explicable signals of sufficient strength to voters about the spending behaviour of local authorities.

Figure 18 :

CHANGES IN AVERAGE RATE BILLS IN GLASGOW CITY AS A RESULT OF THE 1985/86 REVALUATION (ALONE)



The effect of the revaluation (alone) on the average domestic property in Glasgow City is to increase the rate bill from £340 p.a. to £415 p.a. – over £1 per week

(iv) Capital control system

2.22 The present capital control system is intended to enable Government to control the total level of net capital expenditure each year by local authorities (ie their gross capital expenditure less their capital receipts from sales of assets in the year). The system is however flawed because the allocations to individual authorities together with various freedoms and tolerances built into the system enable authorities' total spending to diverge substantially from national planning totals without any individual authority breaking its own limits. In particular, local authorities have freedom to supplement their capital allocations in any year with a proportion of their accumulated receipts or reserves built up in earlier years.

2.23 The logical thing to do to correct this might be to restrict or remove the right of authorities to spend the proceeds of asset sales, particularly those accumulated from earlier years. But this would destroy the incentive for authorities to sell further assets, which is an important political objective; and the controversy over the restrictions that have already been imposed indicate that it would be politically very difficult to reduce any further the right of authorities to spend their "own money" at any rate within the context of the present control system and present levels of planned capital expenditure.

Chapter 3: Reforming The Local Government Finance System

(i) Macro-economic Considerations

3.1 Our pursuit of policies to restrain local authority expenditure and taxation has sharpened perceptions of latent but fundamental flaws in the local government financial framework, and the mechanisms of restraint themselves have a limited life expectancy. But that does not, in itself, suggest that the government should abandon its objective of seeking to constrain the level of local authority expenditure, in order to achieve its main objectives of reducing the overall burden of taxation and limiting the extent of local authority borrowing.

3.2 Government has to be concerned about the overall size of the public sector. High tax rates, necessitated by high public expenditure, impair the efficient working of the economy. They act as disincentives to activity in the private sector, as the rewards of enterprise are diminished. The levels of taxation required to finance a large public sector absorb resources which could be put to more efficient use by the private sector; and a large public sector is likely to be undertaking activities which could be undertaken more efficiently by the private sector, operating under market pressures.

3.3 These arguments apply to taxes raised to finance central and local expenditure alike. But only a limited proportion of local expenditure is financed by local people. Grants from central Government — ie the national taxpayer — finance about 50 per cent of local spending and for some authorities more spending attracts more grant. Almost another 30% is financed by non-domestic ratepayers. Local domestic rates bear on average, only about 20% of the tax-borne costs of local authority services and that burden is concentrated on the 1 in 3 voters who directly perceive that they pay rates.

3.4 In these circumstances the government has been unable to rely on local pressure to deliver restraint in local expenditure and taxation. The Government has sought the delivery of specific local authority expenditure levels derived from its own public expenditure plans. The wrangling between central and local government has therefore been over the delivery of those expenditure levels. Yet delivery of specific expenditure levels for local authorities is not, in itself, essential to the successful management of the economy; it is a means towards achieving the real end of reducing the burden local authorities impose on all taxpayers, which under the current system electoral pressures are failing to achieve.

3.5 On the capital side Government is concerned about the broad level and composition of gross expenditure since capital projects represent the growth point of the local authority sector in response to new needs and pressures. The size and balance of capital expenditure must therefore be brought into reasonable relationship with the Government's perception of overall service needs, and the extent to which local authorities should be meeting them. Government must also be concerned with the general level of local authority borrowing. Curbing the rate of monetary expansion is central to the Government's policies for reducing inflation and laying the basis for sustained economic growth. That in turn requires a downward trend in public sector borrowing if interest rates are to be held to acceptable levels. Higher local authority borrowing makes it harder for the Government to achieve these objectives.

3.6 Under the present system Government seeks, ineffectively, to control net capital expenditure. It exercises no direct control over local authority borrowing, except insofar as the control over net capital expenditure and the prohibition on anything other than temporary borrowing for revenue purposes exercise an indirect influence. As a result total local authority borrowing is higher than it need have been for the given level of expenditure because the interaction of RSG pressures and the capital control system discourage the financing of capital by revenue contributions, ie from the rates. It has also always fluctuated rapidly and unpredictably by up to several billion pounds from year to year.

3.7 For the future it would be desirable in principle to establish a system that enabled a more stable and predictable level of local authority borrowing to be delivered. If this could be established without a direct control over capital expenditure we might reasonably allow capital expenditure greater freedom to find its own level within the constraint implied by the control on borrowing.

(ii) What kind of local government system do we want?

3.8 If the present grant and rating systems cannot meet for much longer the Government's legitimate concern about the level of the local authority tax burden a new framework must be devised. But what that framework should be raises the fundamental question of what kind of local government system we should have in this country.

3.9 There are essentially two choices facing the Government:

either (i) new mechanisms to achieve direct central control over local authorities' spending and/or rate levels, so as to ensure that they conform with Government's policies and priorities;

or (ii) a new "self-regulating" grant and local tax regime in which authorities are made fully and properly accountable to local people , so that the electorate can understand and influence the spending and taxation decisions of their local authority.

3.10 The choice between the two is not influenced by considerations of practicality or efficacy alone. The fundamental issue at stake is whether or not government believes in a reasonably pluralist and decentralised society in which local political choice and self-determination has a part to play within a clearly defined statutory framework, alongside the decentralised economic decision-taking in which we so fundamentally believe as supporters of market choice. Traditionally, the Conservative Party has held to that belief : as we have stressed, that was the other leg of our policy towards local government in 1979. Mechanisms for increased central government control over local authority spending and rates might perhaps ensure delivery of lower spending and taxation levels than would otherwise apply with our present financial system but they run counter to that tradition. Measures to improve the accountability of authorities to their electorates do not; but while we might expect enhanced accountability to lead to local victories for those who wish to reduce expenditure and taxation in many authorities, we must be prepared to accept that in some it may not. What a proper local government financial system should do is to minimise the effect on national economic and fiscal management of the fact that allies of the central government's low spending policy will not hold power in every local authority at all times; and it should ensure that higher local expenditure and taxation are only accepted as local policy when they are chosen by the majority of local taxpayers.

3.11 Improved accountability in respect of current expenditure and its consequences for local taxation does not, however, preclude effective means of influencing local authority borrowing or capital expenditure; indeed we would argue that the two approaches must go hand in hand.

(iii) Increased Central Control

3.12 Leaving aside the issue of principle, mechanisms for increasing central control all have major practical drawbacks. We have considered three such mechanisms.

3.13 First, *a general limit on rates*. This would limit the local tax burden and, together with the control which central government has over grant, it would provide an effective brake on local authority spending. But it would be administratively extremely difficult to operate: central government would either get drawn into the detailed financial affairs of a large number of authorities if tough limits were applied; or it would have to set generous limits to take account of the different circumstances of local authorities which would achieve little in the way of restraint in expenditure or taxation. It would be overtly very centralist and as such would be deeply unpopular for very little gain. Moreover, we do not have such a power on the statute book; in order to secure the passage of the 1984 Rates Act, considerable categories of authority had to be exempted from its reserve 'general' powers.

3.14 Second, *100% central funding of the main local government services* (education, personal social services, police, fire and highway maintenance), with the remainder of services financed entirely locally. This would provide control, at least as effective as that of Whitehall in respect of other centralised services, over about three quarters of local authority expenditure; it would establish a clear division of responsibility between central and local government for services with national characteristics as against purely local services; and it would enable uniform standards to be applied to services financed by central government. However, it would involve a very substantial increase in central government bureaucracy in order to assess accurately the need for services in each local authority and to monitor and supervise their delivery by local authorities. Central government and Ministers would become answerable for every detail of service provision in every local authority and would face pressure to level up standards of service provision in areas where it was alleged to be below average. Local authorities would simply become agents of central government and would lose their incentive to manage services efficently and they would blame central government for all shortcomings. In short, the system would be cumbersome, inefficient and expensive to run and savings in expenditure would not be certain. Meanwhile, sharpened controls would still be needed for locally financed services to prevent an increase in spending on such services as the burden of local tax fell. The outcome would be unpredictable and the game would not be worth the candle.

3.15 Third, *central funding of teachers' salaries*. This would provide direct central control of over half of education spending and one fifth of all local authority spending. It would enable the Government to take over responsibility for the attempt to influence standards of provision in education through the number and grading of teachers. Like central funding of the whole education service, however, central funding of teachers' salaries would require a substantial increase in central government bureaucracy to determine the number and grading of teachers required in each authority (quite possibly in each school) for which central government would become answerable. Like 100% funding of main services, it would only be a means of reducing the levels of rates if mechanisms were put in place to stop other local spending increasing. It would add 4p to the standard rate of income tax or increase VAT by 5%. We believe this option has little to commend it; and if the overriding concern is to secure greater central government influence over the education service we believe this could be more effectively achieved through further development of educational specific grants.

(iv) A self-regulating system

3.16 Both practical and philosophical objections therefore appear to rule out centralist solutions. But we do not advocate a new self-regulating system of local authority finance by default. Given that Government will retain its concern with the burden of local taxation, such a regime is the best choice if it still believes in the principles of pluralism and local choice and accepts that central Government cannot always know best; and if it recognises that in the end spending can only be restrained locally or centrally if enough people are persuaded to vote for such a policy.

Chapter 4: The Elements of a Self-Regulating System

4.1 The key to a new self-regulating local government finance system is greatly improved accountability on the part of local authorities to their electorates and taxpayers. The above analysis suggests that under the present system four principal factors weaken accountability:

— the non-domestic ratepayer represents a non-voting revenue source which local authorities can tap at will

— domestic rates are too narrowly-based a tax: not enough voters pay

— for those who do pay, domestic rates give confusing signals about the level and consumption of local authority services

— the rate support grant system distorts accountability through a resource equalising grant.

These are the problems which have to be addressed if accountability is to be improved.

(i) The non-domestic ratepayer

4.2 In principle, one answer to the lack of representation for the non-domestic ratepayer would be to give him the vote. This was discussed in the 1981 Green Paper "Alternatives to Domestic Rates" (Cmnd 8449). However, it was concluded that the practical problems of trying to devise a workable scheme in a way which would produce a real degree of accountability were overwhelming.

4.3 The decision not to reintroduce the "business vote" was confirmed in the 1983 Rates White Paper. We see no reason to differ. But from that we conclude that it cannot be right for local government to continue to have uncontrolled access to such a large taxpayer to which it is unaccountable. The non-domestic rate is not an appropriate tax to be left to local determination. It does, however, raise a very large sum of money — £6.5 billion in the current financial year, substantially more than the £4.5 billion paid by domestic ratepayers. If non-domestic rates were abolished the income they yield would have to be found from other sources: either from national taxation via Government grants or from domestic ratepayers; or some combination of the two. But whatever alternatives were found, the consequences for individual taxpayers, whether locally or nationally, would be very severe.

4.4 We therefore suggest that non-domestic rates be retained, and the proceeds made available to local authorities, but that control of the level of the rate be transferred to central government. Central government would then be accountable to Parliament for the level of the non-domestic rate (which might be set after consultation with representatives of the non-domestic sector) in the same way as it is for other taxes which bear on businesses. (An essential preliminary would be to have a non-domestic revaluation to put rateable values on an up-to-date comparable basis). Local authorities would then have to finance the full cost of marginal increases in expenditure from those to whom they are accountable, namely local voting taxpayers.

4.5 The second report discusses how non-domestic rate levels might be determined under the new arrangements and how the yield might be assigned to local authorities.

(ii) Domestic rates: a confusing tax which not enough people pay

4.6 If we accept that a property tax no longer serves the interests of local accountability and that enhancing accountability is our prime objective, then we should be thinking in terms of equipping local government with a new tax altogether.

4.7 Our criteria for assessing a new local tax have been based on the need to improve the accountability of local authorities to their electors. On that basis, any new tax needs to satisfy the following criteria:

(i) it should be perceptible

(ii) it should be non-buoyant

(iii) it should be as widely-based as possible

(iv) it should be clearly related to the consumption of local services

(v) it should reflect in an accurate and predictable manner marginal changes in expenditure.

Any new tax should also be compatible with the government's overall taxation policy.

4.8 We have examined again the major alternatives considered in the "Alternatives to Domestic Rates" against these criteria. They are:

(a) reformed domestic rates

(b) local income tax

(c) local sales tax

(d) a charge on all residents (residents' charge).

4.9 Domestic rates meet some of the criteria of accountability, in that they are highly perceptible to those who pay them and non-bouyant. But as we have seen, they fail in other crucial respects. Domestic rates might be brought more closely into line with consumption of services by making some adjustments to reflect the composition of households. But this would create a confusing hybrid tax and continue to give misleading signals to ratepayers. It would be an unsatisfactory half-way house between a straight property tax and a community charge, and would create yet more anomalies.

4.10 A local income tax on the PAYE basis would widen the tax base from the 15 million who currently pay full or partial rates to 20 million income taxpayers. It *could* be made to be perceptible, although at greater administrative cost, if collected by local authorities rather than the Inland Revenue. But it would be administratively complex; it would still leave 15 million electors with no direct financial stake in local spending decisions. The better off would pay more, irrespective of their consumption of local services and it would add to the burden of taxation on incomes;and it would conflict with the steps the government has taken to reduce the burden of direct taxation. It would also, or course, be buoyant, which is why it is the popular choice of most local authority officers.

4.11 A local sales tax would be paid by all consumers in the locality. It would widen the tax base to all residents — and also to a substantial number of non-residents. But it fails the accountability criteria for a number of reasons:

(i) it would be hard to perceive

(ii) it would give local authorities a buoyant source of income, allowing them to fund increasing spending without increasing the rate of tax

(iii) there would be no direct link between paying for local services and voting in local elections, since many non-residents would pay the local sales tax and residents in one authority could shop elsewhere

(iv) the yield is lumpy and not susceptible to fine-tuning to reflect marginal changes in spending

There are further problems given the present structure of local government. The proceeds of a local sales tax would benefit disproportionately regional shopping centres. This effect is particularly stark in conurbations (eg Newcastle would benefit from attracting shoppers from the rest of Tyneside and from Northumberland). So a Local Sales Tax would necessitate equalisation *between* neighbouring authorities.

4.12 The final option is a simple flat-rate charge on all adult residents. This produces the closest fit with local electors. It would widen the tax base from 15 million people to 35 million. It would be clearly related to the level of local authority services, since there would be no need for complex equalisation mechanisms to distort the link between service and cost. It would be perceptible and its yield should both be predictable and easy to fine-tune, so should not distort incentives. For all these reasons, we believe that a form of residents' charge would be preferable to domestic rates as the principal source of locally-raised revenue for local authorities.

4.13 The objections to the residents' charge were well rehearsed in "Alternatives to Domestic Rates." They include concern about the implications of registration of voters; administrative complexity; and the fact that it takes no account of ability to pay. The last is arguably the most important. The level and impact of any community charge would have to be assessed in the context of its effect on the range of household incomes and colleagues will want to see the result of this before reaching a final view. But it would be unrealistic to expect people on low incomes to be able to bear the full cost of the residents' charge, even if benefits were raised to take account of the average level of the charge. The residents' charge would either have to operate with a rebate system or be reflected in supplementary benefit levels. But, unlike the present position with housing benefit, we believe every adult should have to meet some proportion of the residents' charge from their own pocket even if for the poorest the welfare system put the money there in the first place. Automatic 100% rebates for any member of the community undermines the accountability gains from the introduction of a residents' charge.

(iii) The rate support grant system distorts accountability

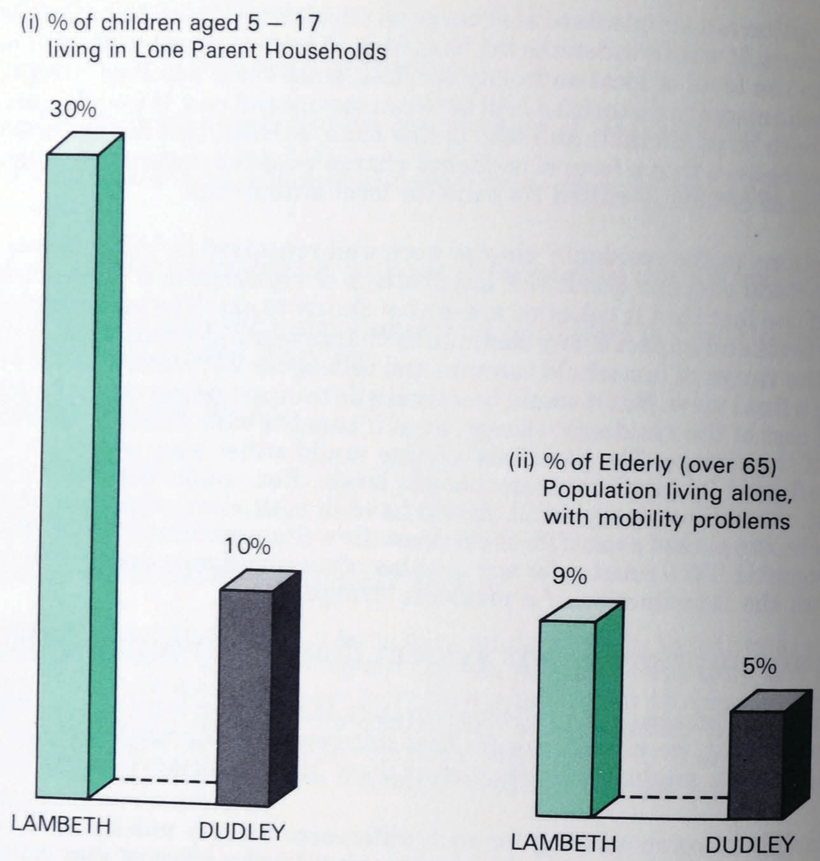
4.14 If the residents' charge is to reflect accurately the relative level of local services and to promote accountability, we need to ensure that differences in the needs and circumstances of local authorities which might otherwise distort those bills are properly compensated for.

4.15 The principle of compensating for such differences already underpins the existing rate support grant system. But as we saw in paragraph 2.19 the effect of also compensating for differences in authorities' rateable resources introduces major variations between different parts of the country in the rate bills levied on comparable properties for comparable standards of service. This is one of the confusing signals which the present grant and rating systems send to domestic ratepayers. However, the switch from domestic rates to a residents' charge deals with this problem, since the taxable capacity per adult does not vary from area to area. There is therefore no need for domestic resource equalisation, once it is accepted that all adults should be liable for the charge.

4.16 Non-domestic rates will be retained under our proposals and the amount of non-domestic rateable resources varies widely between authorities. However, we can compensate for these differences if we pool and redistribute the yield from non-domestic rates on a national basis (following a non-domestic revaluation) as a standard amount per adult. The need for non-domestic resource equalisation through the grant system therefore also disappears.

4.17 There is, however, still a need to compensate authorities for differences in their assessed spending needs, for the kind of reasons illustrated by figure 19. However, because inequalities in resources have already been taken care of, the complex machinery of the present block grant is not required: the only grant we need is a lump sum allocation to each authority calculated according to their needs as assessed by central government formula, and not related to how much they spend.

Figure 19 : WHY NEEDS FOR L.A. SERVICES VARY



4.18 The effect would be that, whatever their varying needs, authorities providing a standard level of service will be able to levy a similar level of residents' charge. If they spend more than this, the whole of the excess will have to be met from a higher residents' charge.

4.19 This makes it all the more important that the needs assessment formula should be perceived to reflect differences in spending needs fairly: there is in particular doubt as to whether the inner urban areas' special requirements are adequately dealt with at present. But we aim, too, to make the formula simpler and more intelligible.

4.20 We should beware, however, of assuming that this proposal should lead to a lower overall level of grant than at present; if we were to constrain the grant to the minimum amount needed to equalise differences in authorities' expenditure needs, the overall level of local taxation would have to increase very substantially indeed.

(iv) Other measures

4.21 We also see merit in pursuing certain other measures which should either promote local authority accountability or redefine the framework within which local government operates so as to strike a sensible balance between the legitimate interests of central government and allowing local government freedom of manoeuvre. These measures are as follows:

— A new framework for the control of capital expenditure or of borrowing which delivers total figures closer to national plans, and which gives individual authorities greater certainty about the available level of resources within which they can plan capital programmes over several years. Following the analysis in paragraphs 3.6 and 3.7 above, there would be attractions in principle in operating the new control on net external borrowing by local authorities, and giving them the freedom to spend in addition on capital in any year any amount which they choose to raise locally either by asset sales within the year or by contributions from revenue. There are, however, considerable practical problems in devising any such system and it would be premature to decide in favour of a borrowing control at this stage before these have been explored further. It may turn out that in the event some form of capital expenditure control (perhaps based on gross expenditure) remains more practicable and could indirectly give a better degree of influence over borrowing as well. A separate paper will be circulated on a range of options shortly.

— a new framework governing the budgetary procedures of local authorities, so that the possibility of deficit financing can be pre-empted and the relationship between local tax levels and local spending levels preserved;

— the possibility of annual elections for all authorities (as happens at present in metropolitan districts and some shire districts) in order to improve accountability and electoral influence over council affairs;

— measures to encourage an increase in the amount authorities raise through fees and charges for their services.

4.22 Finally, we must recognise that, other things being equal, the new financial framework we have recommended will increase the burden of local taxation on the residents of the worst areas of inner city dereliction. This is primarily because the authorities concerned are spending considerably more than their assessed needs now, and in future the entire burden of such excess expenditure will fall on the residents' charge. It may be that the current needs assessment formula fails to reflect the full intensity of the problems of these areas, and we shall be considering this in our revision of the needs assessment arrangements. In addition, extra resources could be allocated to specific activities in these areas by the authorities and central government acting in partnership: this should help to ensure that the resources are put to best effect.

Chapter 5: Conclusion

5.1 Our objective has been to find a new system of local government finance which strikes a balance between on the one hand central government's desire to encourage authorities to operate more economically and efficiently and to constrain the burden they impose on local taxpayers, and on the other hand the need to restore proper local accountability and avoid detailed central government involvement in the affairs of local authorities, which we do not believe to be in central government's best interests.

5.2 We have accordingly focussed on means to improve the accountability of local authorities to local people, so that their electorates may better understand the actions and affairs of their councils, and have both the incentive and the ability to influence effectively those actions and affairs. We believe that in general this will encourage local authorities to behave in a way which is more compatible with the policy objectives on which we fought and won the last two elections. We must accept that in some authorities the electorate may choose differently; but under our proposals such a choice would at least more genuinely reflect the wishes of the majority of local taxpayers than at present. Above all, we believe our proposals offer the best chance of providing a durable, self-regulating system of local government finance from which central government can stand back.

5.3 To local authorities we would be offering a new deal — the most fundamental since the 1830's — whereby we would scrap targets, penalties, block grant taper, the complexity of GRE's, rate capping and perhaps capital allocations, for freedom to set a painful local tax within tighter legal constraints on borrowing and the manipulation of accounts. To local voters we would be offering real power over their councils — with the risk that if they did not vote they might get sharply higher bills — and a shift in local payments towards those who use local services most. The upheaval of domestic revaluations would disappear once and for all. Business would be protected. Central government would be free of its increasing entanglement with local decisions and domestic rates would have been abolished.

5.4 This report has described how we arrived at our recommendations. Our second report provides a detailed specification of these recommendations and a preliminary analysis of their likely effects on the finances of authorities, households and individuals.

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The Local Government Finance Studies

Specification Report

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LOCAL GOVERNMENT FINANCE STUDIES

SPECIFICATION REPORT

Presented to
The Ministerial Steering Committee on Economic Strategy
Sub-Committee on Local Government Finance

by

The Minister for Local Government and the
Parliamentary Under Secretary of State,
Department of the Environment

May 1985

Copy No:

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LOCAL GOVERNMENT FINANCE STUDIES

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SPECIFICATION REPORT

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LOCAL GOVERNMENT FINANCE STUDIES

SPECIFICATION REPORT

CHAPTER 1: INTRODUCTION

A. BACKGROUND

<u>(a) Our remit</u>

1.1 At the seminar at Chequers on 31 March, Department of the Environment Ministers were asked to develop the proposals we had put forward in outline for reforming the present system of local government finance. In particular we were asked to examine the likely overall impact of the changes we had proposed on typical authorities, individuals and businesses; to consider the implications of those changes, including the need for transitional arrangements and for assisting people on low incomes; and to show how the new local tax which we proposed should replace domestic rates - the residents' charge - would work and be enforced.

<u>(b) Structure</u>

1.2 The aim of this report is to fulfil that remit. <u>Chapter 2</u> shows and discusses the preliminary results of our proposals in terms of their broad effects on authorities, businesses and individuals. At this early stage these results are not put forward as an accurate prediction of the <u>scale</u> of the effects: but they do give a broad indication of the likely <u>direction</u> of change. <u>Chapter 3</u> considers what modifications and transitional arrangements may be needed to secure an acceptable distributional pattern without compromising the principles of our proposals. <u>Chapter 4</u> sets out conclusions and proposals for further work.

1.3 In addition, there are nine annexes to this report. Each provides a specification of the various component parts of our proposals and discusses the practical implications.

1.4 This report has been prepared in less than two months since the Chequers presentation and our development work is inevitably at an early stage; there is a great deal more work to be done in consultation with colleagues and their departments before we can be in a position to agree to a detailed package of reforms to serve as a basis for public consultation.

(c) Scotland and Wales

1.5 In the time available, we have been able to relate our analysis and exemplifications only to English authorities. But, as originally agreed by E(LF), the Secretaries of State for Scotland and Wales are associated with our work and our proposals have been developed with a view to their possible implementation in Scotland and Wales as well as in England. Some aspects of local government finance of course vary between the three countries at present and they will no doubt continue to do so under any new arrangements; but if our proposals for reform are agreed it seems inevitable that at least their main features - particularly in relation to local taxation - would have to be adopted in all three countries.

B. GENERAL PRINCIPLES OF A SELF-REGULATING LOCAL GOVERNMENT FINANCE SYSTEM

1.6 Our introductory report explained the rationale which led us to the proposals we have put forward. It identified the inadequate and blurred accountability of local authorities to their ratepayers as the principal reason why the Government's present policies to restrain local authority expenditure and rates had run into political and practical difficulties. It attributed this to fundamental flaws in both the grant and rating systems and argued that major reform of both was necessary.

1.7 As the introductory report fully acknowledged, the Government's objective of reining back the burden imposed by the public sector on taxpayers applied - and should continue to apply - to local government just as much as to central government. But trying to achieve this by pursuing our existing policies in the direction of greater central government control of local authorities is likely in the long run to be politically and practically counter-productive. It would also be incompatible with the commitment - to which we attached so much importance in 1979 - of less central government interference and regulation in local government and in the lives of individual citizens.

1.8 We have therefore argued that the pressures for restraint on local authorities should come not from central government but from greater and more effective accountability on the part of local authorities to local people. We want a self-regulating system which provides the restraints we believe are necessary but which enables central government to stay out of the affairs of individual authorities.

1.9 Our analysis of why local authority accountability is at present so ineffective identified the weak links between those who vote, use and pay for local government services as the major problem. On average, local authorities get more than half of their rate income from the non-voting, non-domestic sector; of those who do have the vote, only about a third directly pay full rates; while the rating system itself sends those who do pay confusing and conflicting signals about the expenditure decisions and behaviour of local authorities. In addition, the current rate support grant arrangements are complex and distorting in their effects.

1.10 Our proposals are primarily addressed to tackling these problems. They also include other measures to promote local authority accountability and to redefine aspects of the framework within which local government operates so as to strike a more sensible balance between the legitimate interests of central government, the need for local authorities to have reasonable freedom in the conduct of their affairs, and the effective capacity of local voters to call their authority to account.

C. A SUMMARY OF OUR PROPOSALS

1.11 Our proposals are described in detail annexes A to H to this report. In summary they are as follows.

(a) National non-domestic rate

1.12 Rates would be retained for non-domestic ratepayers. However, they would no longer be set at the discretion of local authorities but by central government as a national non-domestic poundage (based initially on the current national average poundage). The proceeds would be pooled and redistributed to all authorities as a uniform amount per adult. This is undoubtedly a centralist measure in that it removes one source of income for local authorities. But it is one which enhances local accountability because it requires local authorities to finance the full cost of spending not met by grant or payments from voting taxpayers.

1.13 For the majority of non-domestic ratepayers - over two thirds of whom are in industry and commerce - the proposal should in principle be attractive, since it offers the prospect of stability and protection from excessive rate increases. There will however inevitably be losses for businesses with low rate poundages at present. These will be offset by big gains for business ratepayers in higher rated areas. And from the point of view of central government, pooling and redistribution of the yield of non-domestic rates will go a considerable way to ironing out differences in authorities' taxable resources, thus reducing the need for a resource-equalising grant.

(b) A Lump Sum Needs Grant

1.14 Our proposals involve a new structure for grant to local authorities but need not entail any change in the overall balance between national and local taxation. As now, there would be specific grants for certain purposes. But block grant would be replaced by a lump sum needs grant designed to compensate local authorities for differences in their assessed expenditure needs. Any sum remaining from the desired total of exchequer grant would be paid as a standard flat rate amount per adult. There would be

no resource equalisation. Authorities' grant entitlements would therefore be determined by a needs assessment formula and by their adult population and would not vary according to what they spent.

1.15 Grant distributed on this basis will be much easier to understand and will no longer distort the relationship between marginal increases in spending and what local taxpayers have to pay. If authorities want to spend more than their assessed needs they will have to finance the cost of any excess, £ for £, entirely from local taxpayers. That is good for accountability. Conversely if they choose to spend less, they do not lose grant and the benefit accrues, £ for £, to local taxpayers. That is a good incentive to economy. There will however be redstributional effects. Abolition of domestic resources equalisation will shift money from low domestic rateable value areas to high domestic rateable value areas.

1.16 What taxpayers pay will, however, be more dependent on our needs assessment than at present. We must review our assessment methods to ensure that they are as defensible and comprehensible as we can make them.

(c) Residents' Charge

1.17 Domestic rates would be replaced by a residents' charge. At its simplest, this would take the form of a flat rate levy on all adults resident in an authority. Each district and borough council would compile its own register, which would be separate from the electoral roll. We would aim for as few exemptions from registration as possible. We would at a minimum have to provide rebates for low income families, but in line with the decisions following the social security review, we have assumed that no individual would receive a full rebate of his or her residents' charge.

1.18 This would substantially broaden the present limited tax base of domestic rates to encompass virtually the entire electorate, thus giving all voters a direct stake in the decisions of their local authorities. It would be perceptible, easy to understand and, since it would be non-buoyant, the year on year increases in spending would result directly and explicitly in increases in the residents' charge. Even with a rebate system, the residents' charge would however be more regressive than domestic rates. We should have to accept this as a condition for securing greater accountability.

(d) Targeted aid to inner urban areas

1.19 Our proposals could mean a large cut in the resources of inner city authorities because their expenditure substantially exceeds their needs assessment at present. This is partly a matter of extravagance and inefficiency. But it may also be because it is hard for a generalised system of needs assessment to reflect fully the extremes of multiple deprivation. Changing our assess- ment of spending needs could help, but may well not be enough on its own. We must ensure that the authorities have the resources they need while squeezing out extravagance and inefficiency. Machinery to channel extra help, possibly through a new city grant, will need careful consideration. But a substantial initiative by central government will clearly be required.

(e) Tighter Capital Controls

1.20 While we believe a self-regulating system of local government finance is the only realistic way forward to achieve restraint in local authority current expenditure and taxation, central Government must for reasons of macro-economic policy retain the ability to influence local authority borrowing effectively. We are currently exploring five options for improving the present arrangements based on control of capital expenditure. We are not yet in a position to reach firm conclusions. In principle, there might be advantages in a control on all net external borrowing whether for capital purposes or temporarily in anticipation of revenue income. It would allow authorities greater flexibility to supplement capital spending by transfer from revenue or from sales of assets. But there are considerable practical difficulties in devising a workable system. We are also exploring the fallback option of controlling gross capital expenditure.

(f) Increases in Fees and Charges

1.21 Consistent with our objective of clarifying people's perception of the cost of local services, we propose that authorities should be encouraged to increase the amount of revenue they raise through direct fees and charges to consumers. At present local authorities in England recover about £2.2 billion through existing fees and charges - some 7% of their spending financed from their rate fund. We might be able to increase this figure by up to £500 million by putting pressure on authorities to conform with "best practice".

1.22 If we want to raise more than this - as ideally we would - we would need to contemplate introducing new charges for services such as fire protection, nursery education and libraries: we might also need to consider ways of devising charges for non-domestic ratepayers (and corresponding reductions in non domestic rates) to reflect in some way the benefits businesses derive from local authority services. Either approach would, however, be very controversial.

(g) Annual elections

1.23 Present electoral arrangements are not ideal from the point of view of local accountability. We would like to see a simpler and more uniform system which the voter could understand and which would call all authorities to account at frequent intervals. The choice is a finely balanced one. But our present inclination is to propose extension to all authorities of the system which already applies in all metropolitan and some non-metropolitan districts - annual election by thirds. In its 'pure' form, allowing every elector to vote every year, this would need a complete redrawing of the electoral map to create three-member divisions and wards in all the authorities concerned. In the interim, we would need to graft annual elections on to the present ward pattern. This would be workable (even perhaps in the longer term) in the counties but less so in the district and London boroughs.

(h) A new framework for local authority budgeting

1.24 Local authorities are at present subject to no explicit requirements on the form or content of their budgets, except that the rate set must be sufficient to provide for estimated expenditure. Yet the budget process is a highly important one which has major implications for local people. Accountability depends on a clear link between spending decisions and local taxes levied. The creative accounting practices which have emerged in recent years should largely disappear with the reform of the grant system we propose; and if we should adopt annual elections for all councils the manipulation of reserves to hold down rates in election years should also end. But there is still the possibility of "deficit financing" (i.e. levying a rate of tax which may prove to be insufficient to cover planned expenditure) in a few authorities. The risk of this might increase under our proposed reform.

1.25 To preserve the link between spending and local tax rates we therefore propose that we should explore the scope for establishing a legal requirement on authorities to produce "sincere" budgets, backed up by a procedure enabling the auditor to vet selected budgets where certain "triggers" are activated.

D. THE PROPOSALS AS A WHOLE

1.26 Together, our proposals add up to an approach which will spread the cost of financing local authority services to all voters; force local authorities to finance additional spending from local voting taxpayers; and clarify to voters the link between expenditure on services and the cost of financing it.

1.27 Under our proposals central government would control the non-domestic rate, grants to local authorities and borrowing. Central government would thus have direct control over the burden local authority spending places on the national and business taxpayer. But it would no longer purport to deliver a predetermined total of local authority expenditure. If local people wanted to vote for more local spending <u>and</u> were prepared to pay for all of it, we would let them.

1.28 That might appear a recipe for higher local authority expenditure. It should not be. We would be doing away with the complicated and unpopular apparatus of targets, tapers and holdback used now to place pressure on local authorities. But we would be replacing them with a system which imposed a severe price on <u>all</u> local authorities for <u>every</u> percentage increase in their spending. We would no longer be in the business of judging "allowable" spending increases for each authority based on its previous year's spending.

1.29 There is another feature of our proposals which suggests spending should be lower rather than higher. The present system gives authorities few incentives to budget down. The proposed new system would allow authorities to pass on the full benefit of reductions in their spending. There would be no sharing of cost savings and cost increases between local taxpayers and the government as happens at present. Every 1 per cent increase in spending will cost the local taxpayer 4 per cent on his residents' charge. Every 1 per cent reduction in spending will reduce his bill by 4 per cent. That should give across-the-board incentives to economy impossible under the present system of top-down containment of local authority spending.

1.30 At the same time, we must recognise that the introduction of our proposals - particularly those relating to non-domestic rates grants and the residents' charge - will as they stand have potentially major effects on the finances of authorities, businesses and households, some advantageous, some not. These are discussed in Chapter 2. Chapter 3 looks at possible modifications to moderate the more extreme effects and transitional arrangements to ease the introduction of the new system. Our conclusions, and suggestions for further work, are summarised in Chapter 4.

CHAPTER 2: RESULTS

A. INTRODUCTION

2.1 This chapter gives the results of the preliminary development work we have done in the six weeks since 31 March.

2.2 The package we are showing incorporates

- a national non-domestic rate;
- a lump sum needs grant;
- a residents' charge incorporating the social security review rate rebate proposals.

2.3 The results are purely illustrative. We are showing a very basic package with no refinements made at all. In particular

- we have not incorporated any special London arrangements, though such arrangements have been an important feature of the local government finance system for many years;
- we have not assumed any changes to the flow of grant to support higher spending needs in urban areas;
- we have not incorporated any transitional arrangements either for areas or households;
- we have not assumed any changes to local authority spending behaviour.

2.4. These early results therefore show only the broad direction of change. They do not show the likely scale of change or the detailed distributional effects. In the light of the committee's views, there are a number of modifications and transitional arrangements we can make to give a more realistic and acceptable outcome. The range of refinements available to us is set out in Chapter 3.

B. RESULTS

2.5 The results we have produced so far are shown in three sections

I The effects on areas
II The effects on particular household types
III Numbers of gainers and losers

SECTION I: EFFECTS ON AREAS

2.6 This section describes how the effects of our basic proposals (without refinements) would vary in different areas for domestic and non-domestic local taxpayers.

a. The effects on domestic taxpayers

2.7 The average local domestic taxpayer would be better off under the new arrangements in over two thirds of rating authorities. He will tend to be better off in two sorts of area:

i. Low spending areas

These gain from sharing the proceeds of the national non-domestic rate set at the national average level. On average the contribution from domestic taxpayers in non-metropolitan areas would fall by more than 20%.

ii. Areas outside London with high domestic rateable values

These benefit from the abandonment of attempts through the grant system to compensate areas with low domestic rateable resources. The Home Counties all fare particularly well.

2.8 Domestic taxpayers will tend to be worse off in the following type of area:

i. High spending areas

The whole burden of financing expenditure above assessed expenditure needs is shifted on to the domestic taxpayer. Kodak will no longer be subsidising Camden's excessive spending. Every £1 (per adult) spent by Lambeth over its assessed expenditure need will increase the residents' charge by £1. As a result, unless spending is cut, domestic taxpayers in a number of high spending metropolitan districts and London boroughs would be significantly worse off.

ii. Areas with low domestic rateable values

These areas - largely outside the South East and Midlands - no longer benefit from the extra government help to compensate for their low domestic rateable values (resources equalisation).

iii. London

Successive grant regimes have put London into an advantageous position compared with the rest of the country in order to moderate the higher rate bills resulting from its high rateable values. At present, 26% of London's rateable resources are left out of account when calculating its grant. In addition, the rich central London boroughs, GLC and ILEA who receive no grant nevertheless receive a bonus (running up to several hundred £ million) from their abnormally high non-domestic rateable resources.

2.9 The package shown in this report has not been modified to continue the special London arrangements. The effect, when taken together with some very high spending in Inner London is a massive and implausible (80% average) increase in the burden faced by domestic taxpayers in Inner London. Our view is that we shall almost certainly need special London arrangements (see Chapter 3). On that basis, the London results shown in this report must be regarded as subject to major modification in the final package. 14

b. The effects on non-domestic local taxpayers

2.10 If non-domestic rates are set at the national average businesses will pay lower rates in high spending areas where rates are correspondingly high, but higher rates in low spending areas where they are low. The effects are shown in Annex A. The biggest gains are for businesses in inner London and high spending northern cities (20-30% reductions). Against this, rate bills would increase for businesses in low spending rural areas, particularly in the south east. In general the gains for business taxpayers will occur in areas where domestic taxpayers lose and vice versa. The scale of the changes for many individual businesses would however be much less than the changes which will result from a non domestic revaluation which will needed in due course.

c. How the residents' charge would vary

2.11 Tables 1 and 2 (at the end of this chapter) summarise the key results.

2.12 To replace domestic rates with a residents' charge requires a national average charge of £160 per adult. Under our proposals, some 90% of authorities would have a charge within the range £60-£200 per adult, although for a very small minority of authorities - all in London - the charge would exceed £300 per adult, up to a maximum of £780 per adult. Only part of this variation is attributable to our proposed reforms to grant and non domestic rates.

2.13 Table 1 shows that even under the present financial regime, the wide variations which exist in domestic rate bills between areas produce a range of variation in the cost per adult across the country which is almost as large.

2.14 Nevertheless our proposals do produce some large shifts in the burden of domestic taxes between areas. These are brought out in Table 2 for some illustrative groups of authorities. It shows that there are some big shifts in the burden of local domestic taxes, particularly in London. It is useful in suggesting the direction of change. The scale of change for gainers and losers will be affected by the arrangements discussed in chapter 3.

SECTION II: THE EFFECTS ON SAMPLE HOUSEHOLDS

2.15 What might the impact be of our proposals on household income? To show this, we have chosen a range of standard households in a sample of local authorities. We have then calculated weekly local tax bills after rebates, as percentages of household income (net of income tax and national insurance contributions.)

2.16. The results for a selection of these households in eight local authorities are given in Table 3 at the end of this chapter. While these serve to give an indication of some of the most marked distributional changes, the households shown are not necessarily the most typical. We should emphasise that our analysis is confined to owner-occupiers; this is because of the difficulties of attributing housing benefit, under the proposed new rebate scheme, to rents and rates respectively.

2.17 We have built up the results in three stages:

- First we have grafted the changes following the social security review onto the existing pattern of rate bills (to show these effects in isolation).
- Second, we have incorporated the new grant and non domestic arangements but retained domestic rates (to show the effects of the new grant/non-domestic rate arrangements in isolation).
- Third, we have replaced domestic rates with the residents' charge (to show the effects of the entire package.)

a. Effects of Housing Benefit changes in Social Security review

2.18 There are three main effects:

a. to make all ratepayers including those on Supplementary Benefit pay at least 20% of their rate bill;

b. to increase the proportion of income paid in rates by owner-occupied households with modest incomes above the Supplementary Benefit level (allowing for disregards);

c. to reduce by 40% the number of households not on Supplementary Benefit who receive rate rebates.

b. The impact of new grant and non-domestic rate arrangements

2.19 In high spending authorities, the effect of making domestic ratepayers pay the full cost of spending above GRE is to substantially increase the burden of local taxes for all households. When this is combined with the results of the Social Security review some low income households in a few of the highest spending authorities, could find their rate bills doubled or even trebled. The effects are most marked in London (since the figures do not reflect a continuation of special London arrangements).

2.20 Conversely, there are modest gains to all ratepayers in low spending authorities under the new grant system with rate bills falling as a percentage of income by 1-2 percentage points.

c. Replacing Domestic Rates with a Residents' Charge

2.21 This affects mainly the distribution of the local tax burden between households in an area - rather than the total size of the tax burden. It produces substantial shifts in tax incidence between households. The main gainers and losers are as follows:

Gainers	Losers
Single person households	3 or more adult households
High rateable value households	low rateable value households
Better off households	Poorer households

2.22 The biggest gains are for single person and 2-adult households in high rateable value property in high spending authorities, for whom the reduction in tax resulting from the move to a residents' charge more than outweighs the adverse effects of our grant proposals.

Two examples illustrate this:

A single non pensioner with gross income of £250 living in a high spending outer London borough could end up paying only 4% of net income in local taxes compared with 9% at present.

A couple with two dependent children with a gross income of £450 per week, living in a prosperous urban centre would pay only 2% of their net income in local taxes compared with 5% at present.

2.23 The biggest losses are for households with two or more adults in low rateable value property in high spending areas where the effects of a high residents' charge payable by each adult produce further large increases in the proportion of net income paid in local taxes.

Two examples illustrate this:

A pensioner couple living in a northern industrial centre (high spending) with a gross income of £75 per week could pay getting on for an extra four percentage points of net income in local taxes, and the combined effect of our proposals would raise the proportion from less than 3% at present to 10%.

A three adult household in a second northern industrial centre (high spending) with a gross income of £150 per week might have to pay almost an extra two percentage points of net income in local taxes as a result of the residents' charge. When combined with the results of the Social Security review proposals and the reform of grant and non domestic rates the effect would be nearly to treble the proportion of net income paid in local taxes - from 4% to 12%. For a comparable household in London, the increases could be even greater.

2.24 In sum, for poorer/low rateable value households in high spending areas, the effect of moving from rates to a residents' charge is to accentuate the losses already envisaged as a result of the Social Security review housing benefit proposals and our proposals for reforming grant and non domestic rates. But for better off/high rateable value households in such areas, the gains from the residents' charge tend to more than offset the adverse effects of our other proposals. The relationship between the proportion of net income paid in local taxes and income levels under different financial regimes is shown for some illustrative households in different types of authority in table 4 at the end of this chapter. This shows how, under the proposed residents' charge, the proportion of income paid in local taxes tends to decline as income rises for those households not in receipt of housing benefit.

SECTION III: NUMBERS OF GAINERS AND LOSERS

2.25 Finally, we have carried out some preliminary work with DHSS on modelling the effects of the basic package on almost 6,000 households in England, using the Family Expenditure Sample survey. The purpose is to give some broad national indication of the numbers of households who gain and lose under our proposals and the range of effects. The proposed new rate rebate benefit scheme has been assumed to apply throughout, so that the effects of introducing this scheme are excluded from the changes shown below.

2.26 The results have been calculated in two stages:

i. The effects of implementing the new grant and non domestic rate arrangements without replacing domestic rates

The number of gaining and losing households can be summarised as follows:

Gains

100,000 (0.6%)	of households gain	more than £5 per week
2,100,000 (12.4%)	" " "	between £2-5 per week
8,000,000 (48.2%)	" " "	less than £2 per week
Total: 10,200,000		

Losses

5,000,000 (29.8%)	" "	lose less than £2 per week
950,000 (5.7%)	" " "	between £2-5 per week
450,000 (2.7%)	" " "	between £5-10 per week
100,000 (0.6%)	" "	more than £10 per week
Total: 6,500,000		

2.27 These results show that more householders gain than lose from our basic grant package (without the residents' charge) but that there is a wider spread in the size of the losses. As we have made clear throughout this chapter, we shall need to try to mitigate the heaviest losses, which occur in Inner London, by special London arrangements. We shall also need to consider how best to alleviate some of the large losses being incurred in a number of the higher spending northern industrial areass. Under the present basic package, a total of 650,000 households would face losses of over 3% of their net income.

ii. New grant and non domestic rate arrangements with residents' charge replacing domestic rates

The replacement of domestic rates with the Residents' Charge, when combined with our other proposals provides the following patterns of gains and losers:

Gains

750,000 (4.4%)	of households gain	more than £5 per week
3,000,000 (17.7%)	" " "	between £2-5 per week
5,500,000 (33.8%)	" " "	less than £2 per week
Total: 9,250,000		

Losses

4,500,000 (26.2%)	" " lose	less than £2 per week
1,900,000 (11.5%)	" " "	between £2-5 per week
700,000 (4.2%)	" " "	between £5-10 per week
350,000 (2.2%)	" " "	more than £10 per week
Total: 7,450,000		

2.28. The effect of the introduction of the residents' charge is to make a further one million households worse off and to increase the number of households who gain and lose more than £5 per week. For one and a quarter million households losses would amount to more than 3% of net income.

2.29 Finally, Table 5 shows the distribution of net local tax payments as a proportion of income, under the present system (but incorporating the new rebate scheme) and under our proposals, with the residents' charge. The broad distribution pattern is very similar, although the position of individual households may differ significantly.

2.30 It must be stressed that these results are highly sensitive to some of the assumptions we have used. And in the time available, it has only been possible to indicate the effects on households rather than individuals who would be liable for the residents' charge.

C. CONCLUSION

2.31 The results of our preliminary work show that for the great majority of households and areas the changes arising from our new system would be relatively modest. In a limited number of cases some of the results of the basic package as it stands will prove unacceptable. But we see scope for refining the basic package, without undermining its essential principles, in a way which will moderate the more extreme effects on areas and households. The possibilities are discussed in Chapter 3. Further work will be needed to assess the feasibility of these options and their redistributive effects.

TABLE 1

Cost Per Adult : Current System And Proposed System

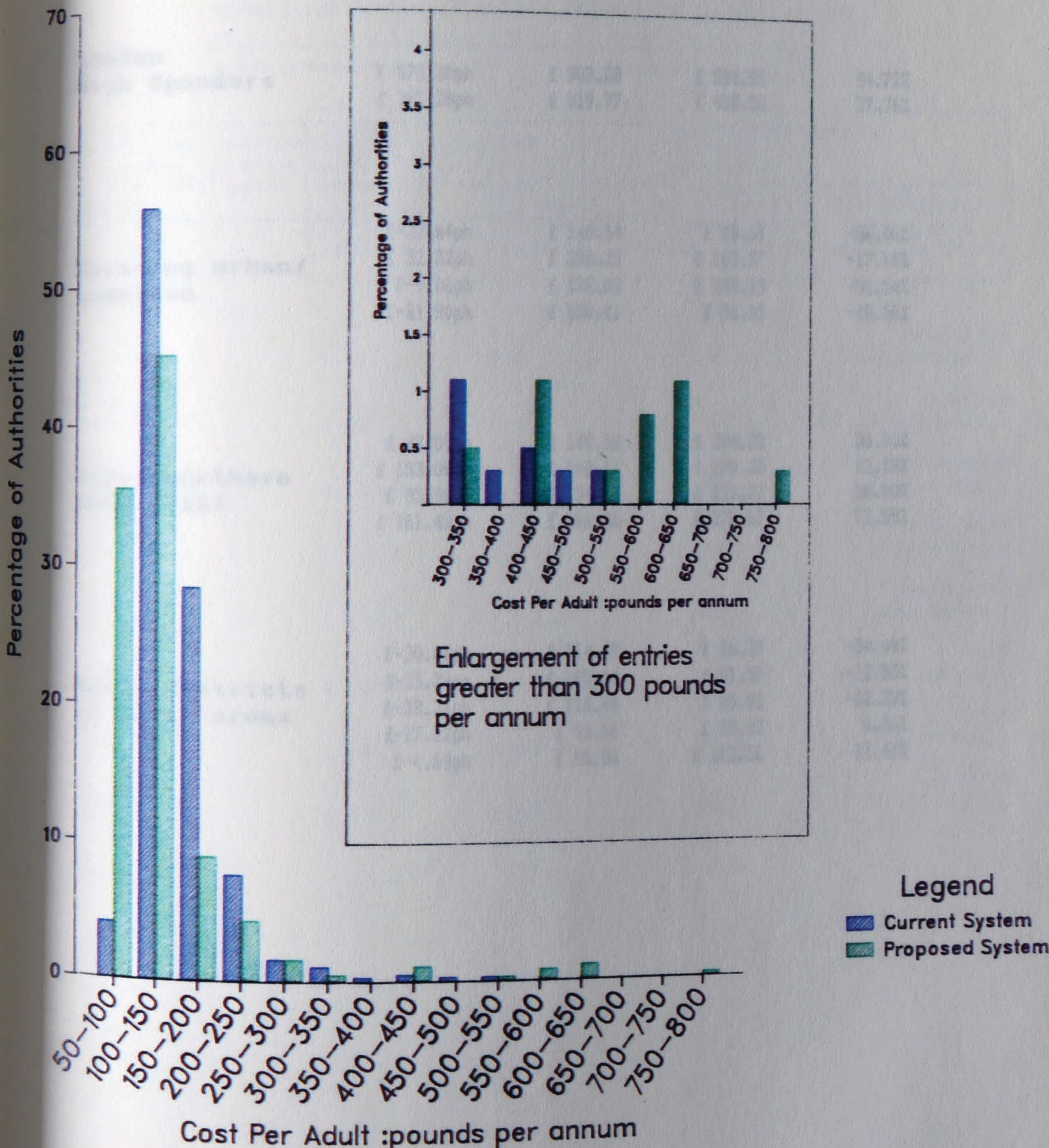


TABLE 2

Change In Local Domestic Tax Bills (based on 1984/85 data)

	Overspend on GRE	Local tax paid per adult: Now	Local tax paid per adult: New System	Local tax paid per adult: Percentage change
London High Spenders	£ 473.30ph	£ 303.28	£ 590.55	94.72%
	£ 291.28ph	£ 319.77	£ 408.53	27.76%
Thriving urban/ suburban	£-27.64ph	£ 140.14	£ 89.61	-36.06%
	£ 52.52ph	£ 206.23	£ 169.77	-17.68%
	£-9.06ph	£ 176.03	£ 108.19	-38.54%
	£-21.90ph	£ 160.41	£ 95.35	-40.56%
Older northern industrial	£ 87.00ph	£ 149.18	£ 204.25	36.92%
	£ 153.06ph	£ 190.11	£ 270.30	42.18%
	£ 95.96ph	£ 154.50	£ 213.21	38.00%
	£ 161.42ph	£ 161.46	£ 278.67	72.59%
Shire districts in rural areas	£-30.88ph	£ 114.37	£ 86.37	-24.48%
	£-25.28ph	£ 105.16	£ 91.97	-12.55%
	£-28.24ph	£ 114.44	£ 89.01	-22.23%
	£-17.82ph	£ 93.66	£ 99.42	6.16%
	£-4.69ph	£ 95.86	£ 112.56	17.41%

Table 3 (a)

Household type: SINGLE PENSIONER

Income level: £75 per week gross, £67.6 per week net

Accommodation Terraced house, owner occupied

WEEKLY LOCAL TAX BILL AS A PROPORTION OF NET INCOME

	Present Rebate Scheme	New Rebate Scheme		
	Present financial regime	Present financial regime	New financial regime with domestic rates	New financial regime with residents charge
	%	%	%	%
Northern industrial (1)	5.5	5.5	7.7	5.8
Northern industrial (2)	7.3	7.3	10.6	8.0
Prosperous urban (1)	3.5	3.5	3.1	2.8
Prosperous urban (2)	5.6	5.6	5.7	4.4
Prosperous suburban	5.4	5.4	3.1	2.7
Inner London	8.0	10.3	17.9	17.1
Outer London(1)	8.2	10.8	12.2	9.2
Outer London(2)	7.3	8.5	7.0	4.8

Table 3 (b)

Household type: SINGLE NON-PENSIONER (living alone)

Income level: £250 per week gross, £164.6 per week net

Accommodation: Purpose built first floor flat, owner occupied

WEEKLY LOCAL TAX BILL AS A PROPORTION OF NET INCOME

	Present Rebate Scheme	New Rebate Scheme		
	Present financial regime	Present financial regime	New financial regime with domestic rates	New financial regime with residents charge
	%	%	%	%
Northern industrial(1)	3.7	3.7	5.2	2.4
Northern industrial(2)	5.2	5.2	7.5	3.3
Prosperous urban(1)	3.2	3.2	2.9	1.2
Prosperous urban(2)	3.7	3.7	3.8	1.8
Prosperous suburban	4.5	4.5	2.5	1.1
Inner London	8.9	8.9	15.5	7.0
Outer London(1)	9.1	9.1	10.3	3.8
Outer London(2)	5.3	5.3	4.4	2.0

Household type: PENSIONER COUPLE

Income level: £75 per week gross, £75 per week net

Accommodation: Terraced house, owner occupied

WEEKLY LOCAL TAX BILL AS A PROPORTION OF NET INCOME

	Present Rebate Scheme	New Rebate Scheme		
	Present financial regime	Present financial regime	New financial regime with domestic rates	New financial regime with residents charge
	%	%	%	%
Northern industrial(1)	2.9	5.0	6.9	10.5
Northern industrial(2)	3.6	6.6	9.5	14.3
Prosperous urban(1)	2.2	3.1	2.8	5.1
Prosperous urban(2)	3.0	5.1	5.2	7.9
Prosperous suburban	2.9	4.9	2.8	4.9
Inner London	4.6	9.3	16.2	21.9
Outer London(1)	4.8	9.8	11.0	16.6
Outer London(2)	4.0	7.6	6.3	8.7

Table 3 (d)

Household type: COUPLE WITH 2 DEPENDANT CHILDREN

Income level: £450 per week gross, £307.2 per week net

Accommodation: 1960s Detached house, owner occupied

WEEKLY LOCAL TAX BILL AS A PROPORTION OF NET INCOME

	Present Rebate Scheme	New Rebate Scheme		
	Present financial regime	Present financial regime	New financial regime with domestic rates	New financial regime with residents charge
	%	%	%	%
Northern industrial(1)	4.2	4.2	5.8	2.6
Northern industrial(2)	5.5	5.5	7.9	3.5
Prosperous urban(1)	3.1	3.1	2.7	1.2
Prosperous urban(2)	4.9	4.9	5.0	1.9
Prosperous suburban	4.3	4.3	2.4	1.2
Inner London	7.5	7.5	13.0	7.5
Outer London(1)	6.8	6.8	7.7	4.0
Outer London(2)	5.2	5.2	4.3	2.1

Table 3 (e)

Household type: NON-PENSIONER COUPLE WITH ONE CHILD AND ONE NON-DEPENDENT ADULT

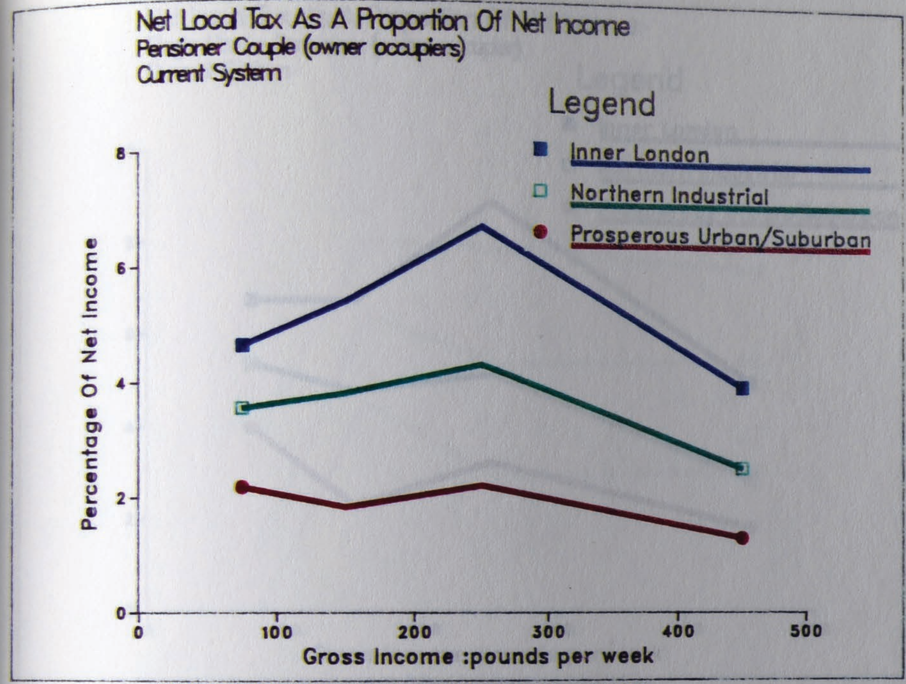
Household income level: £150 per week gross, £136.0 per week net

Accommodation: 1960s Semi-detached house, owner occupied

WEEKLY LOCAL TAX BILL AS A PROPORTION OF NET INCOME

	Present Rebate Scheme	New Rebate Scheme		
	Present financial regime	Present financial regime	New financial regime with domestic rates	New financial regime with residents charge
	%	%	%	%
Northern industrial(1)	3.8	5.6	7.7	8.7
Northern industrial(2)	4.4	7.0	10.1	11.9
Prosperous urban(1)	3.1	3.7	3.3	4.2
Prosperous urban(2)	3.8	5.6	5.8	6.5
Prosperous suburban	3.8	5.5	3.1	4.1
Inner London	5.7	10.2	13.2	20.0
Outer London(1)	6.0	11.0	12.1	13.7
Outer London(2)	4.5	7.3	6.0	7.2

TABLE 4a



N.B. DIAGRAMS DRAWN TO DIFFERENT SCALES

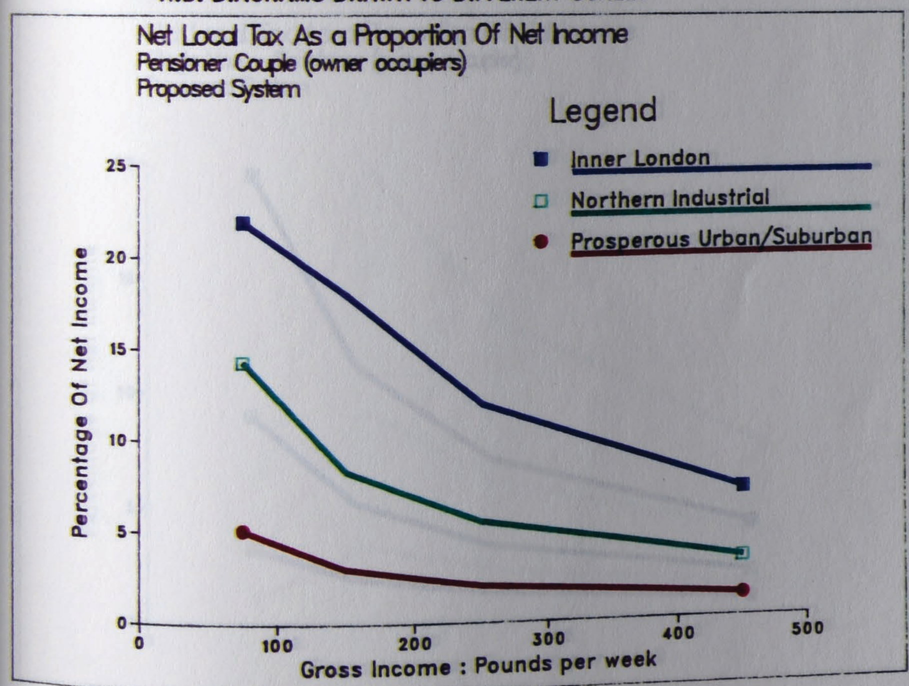


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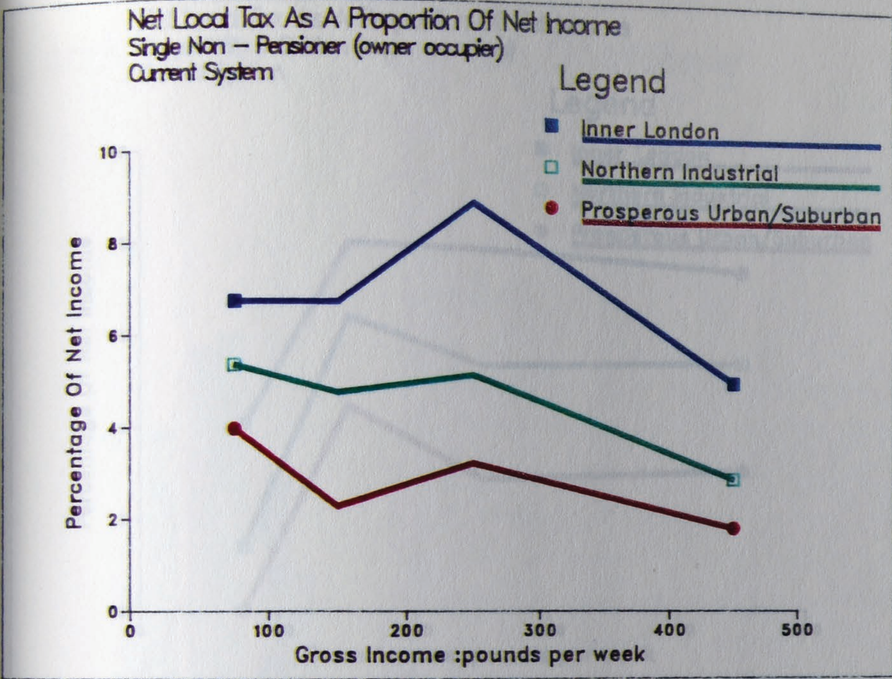
TABLE 4b



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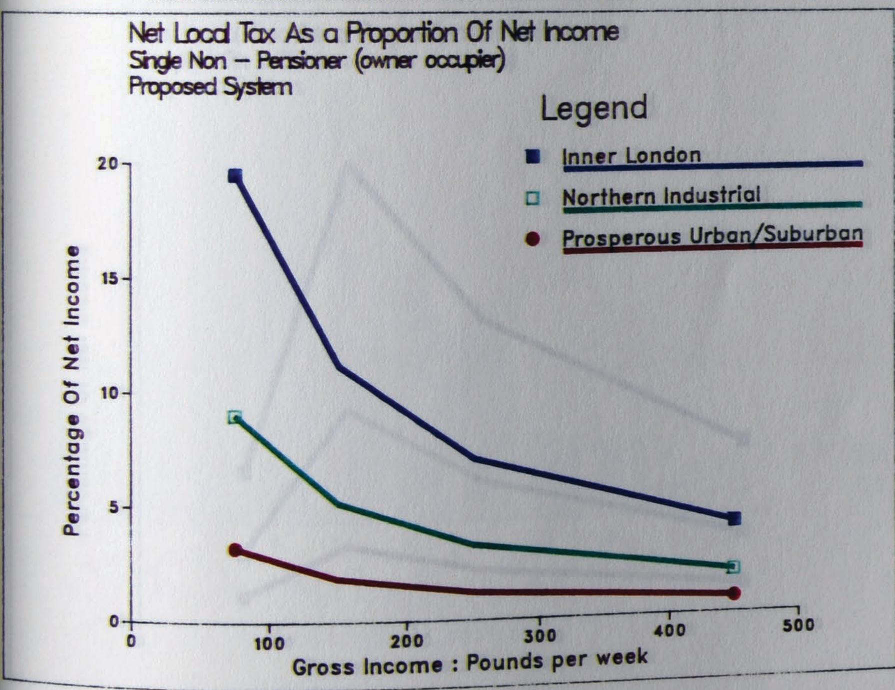

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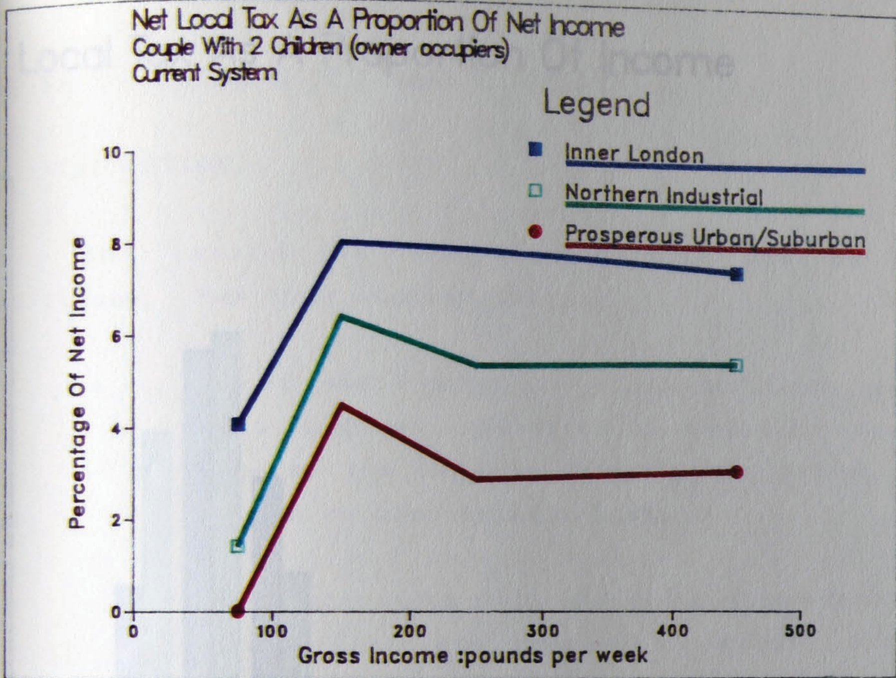
TABLE 4c



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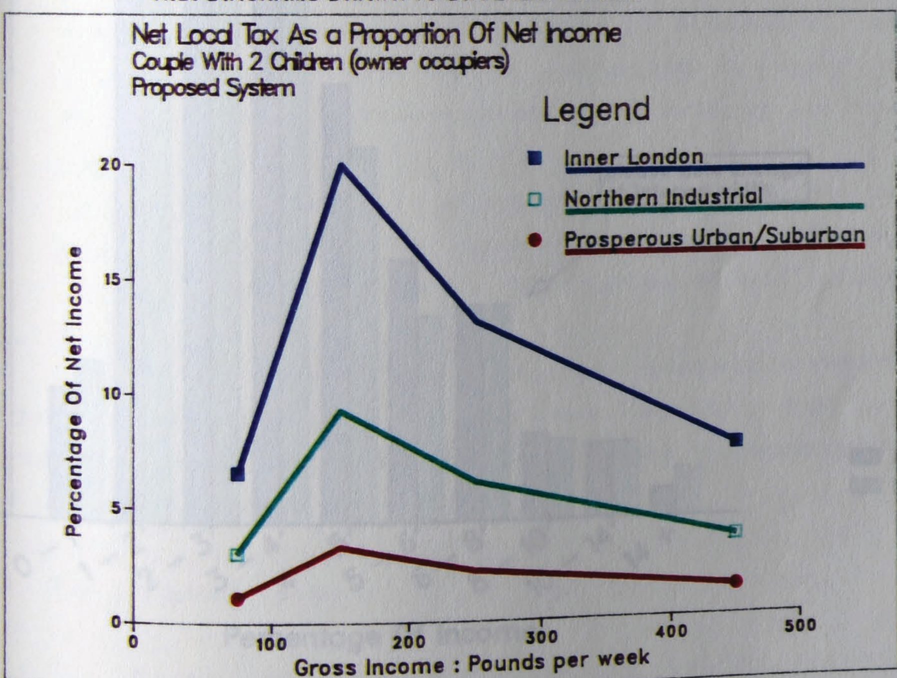

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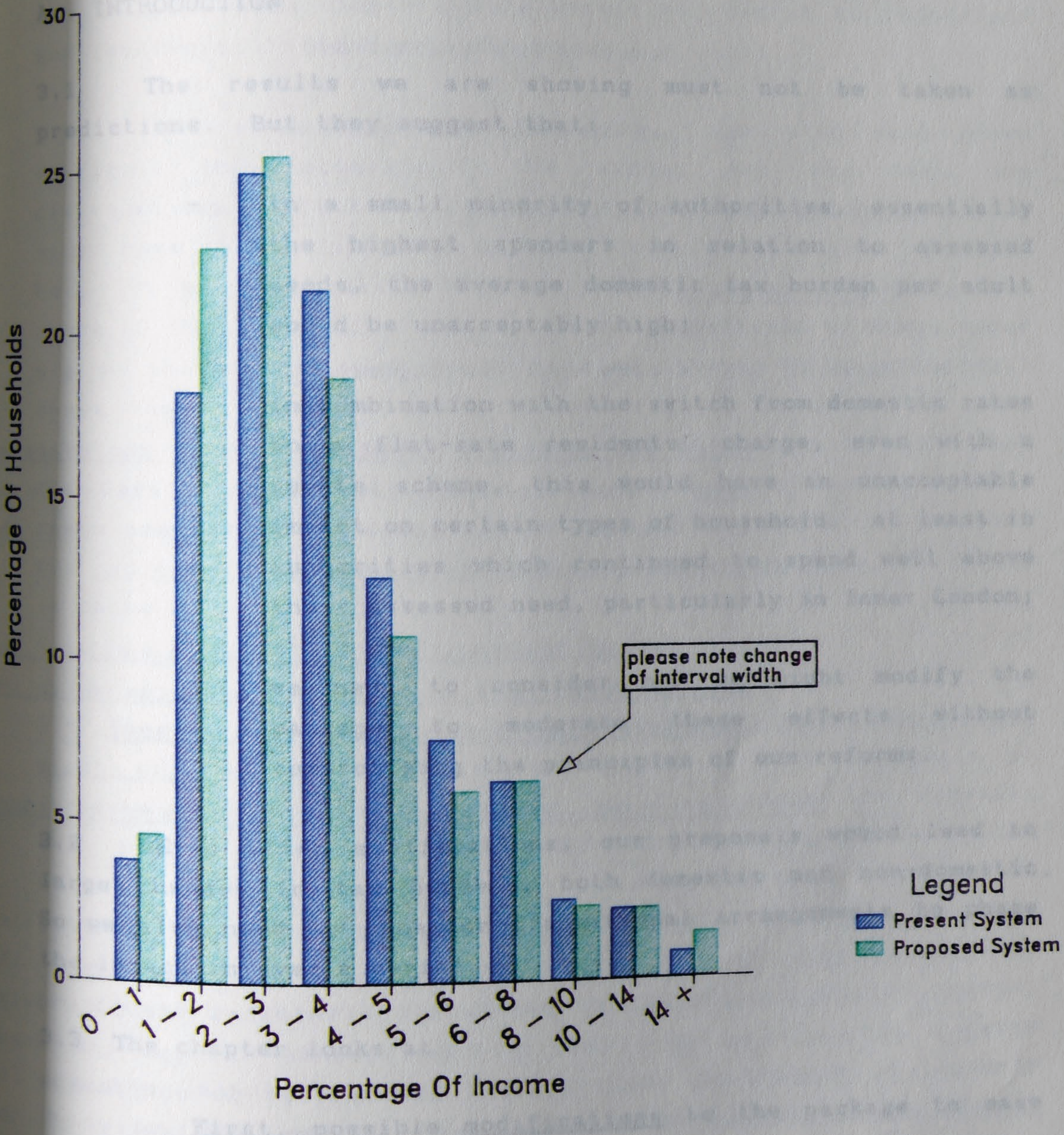
Table 5

Local Tax As A Proportion Of Income



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CHAPTER 3: REFINEMENTS TO BASIC PACKAGE

A. INTRODUCTION

3.1 The results we are showing must not be taken as predictions. But they suggest that:

- in a small minority of authorities, essentially the highest spenders in relation to assessed needs, the average domestic tax burden per adult would be unacceptably high;
- in combination with the switch from domestic rates to a flat-rate residents' charge, even with a rebate scheme, this would have an unacceptable impact on certain types of household, at least in authorities which continued to spend well above their assessed need, particularly in Inner London;
- we need to consider how we might modify the package to moderate these effects without compromising the principles of our reforms.

3.2 Even after modifications, our proposals would lead to large changes in tax burdens, both domestic and non-domestic. So we also need to consider transitional arrangements to phase the impact in over a period.

3.3 The chapter looks at

<u>First</u>, possible <u>modifications</u> to the package to ease the largest tax burdens on

(a) areas and

(b) individual households

Second, possible transitional arrangements to phase in changes in

(a) domestic tax burdens and

(b) non-domestic tax burdens

B. MODIFICATIONS TO BASIC PACKAGE

(a) Impact on areas

3.4 Domestic tax burdens would be highest

- where the authority spends more than its assessed need. Domestic taxpayers would pay the whole of the excess. Non-domestic ratepayers and the Government would no longer contribute.

- in Innner London, where, additionally, the special advantages in rateable resources which the authorities currently enjoy would be lost.

(i) Reform of needs assessment; targeted aid to inner areas.

3.5 It is crucial to our proposals that if authorities provide above average services local voters should meet the full cost of the excess. But need for services varies widely and so does its unit cost. Block grant, through the Grant Related Expenditure (GRE) system, is supposed to compensate for these differences now. But, for all the complexity of the methodology we doubt whether it picks up successfully the full range of differences in authorities' spending needs. Many authorities spending in excess of their GRE do so partly because of expensive local policies, or inefficiency. But in some areas notably in London, our view is that the GRE probably under-represents the cost of an average level of service. (The personal social services, for instance, even very low spending London boroughs such as Wandsworth, Kensington and Chelsea, and Croydon are spending well over their GRE).

3.6 In Annex B below, we recommend that our existing methods of needs assessments should be reformed. We would aim to make them simpler, more sensitive, easier to understand and less volatile from year to year.

3.7 This is a substantial task. Our aims will prove difficult to reconcile. We cannot yet say what the distributional effects of a revised system would be. But while we would hope that an improved national formula would give them some help, it may well still fail to reflect adequately the severe needs of the inner city areas. Since the problems of these areas are so intractable, and since in some (though by no means all) cases the authorities concerned are failing to run their main services effectively and efficiently, we also think it right that the Government should take a hand in deciding how additional resources for these areas should be spent. Hence the proposal for additional targeted grant aid to inner urban areas, discussed in Annex D.

(ii) Special London arrangements.

3.8 Removal of Inner London's privileged position in the present grant system is a logical consequence of our proposals to 'nationalise' non-domestic rates and to replace the domestic rate with a residents' charge. But the impact on domestic tax bills, particularly in lower spending boroughs, would be extremely severe. Besides, we still see a case for allowing Inner London to keep a proportion of its additional non-domestic rateable resources, in recognition of the special role of the inner boroughs in providing services for a large commuting population, for tourists, and in support of London's role as the metropolis. We recommend therefore that London's resource advantage should be reduced rather than wholly removed. Mechanics will need more thought. It might even be possible to invent a new tax - perhaps a tourist tax - which would provide an additional source of income for London while reflecting some of the costs which fall on London as a metropolis.

(b) Impact on individual households

3.9 It is essential to our proposals that all adults, with the bare minimum of exceptions, should pay towards the cost of local services. The incidence of a flat rate residents' charge would inevitably be more regressive than that of domestic rates, even if a similar rebate system were to apply.

3.10 Central to our willingness to contemplate a flat rate residents' charge is our belief that the principal purpose of the local tax is the maintenance of local accountability, not the redistribition of income. A non-progressive tax does the former effectively; that is its strength. Income redistribution we would argue, should be the duty of central government. Therefore a strong case could be made for saying that it is wrong to criticise an effective local tax for having by itself unsatisfactory redistributional effects.

3.11 If such effects arise, they should arguably be corrected by central government's taxes and benefits, and not by damaging the simplicity and effectiveness of the proposed local tax. A whole range of benefit changes and income tax changes could be devised to manipulate the total tax burden (including the new local tax). We think it will be necessary to modify the impact of our proposed residents' charge by one means or another, and do not think that attention should focus only on modifications to that tax itself, or the local tax structure as a whole.

3.12 The acceptability of the redistributional effects will in any case depend on the amount of the residents' charge. The average, on our assumptions (1984/85 figures) would be around £160 per annum. The range between areas is very wide on our present exemplifications, but the action we propose in (a) above should reduce it; so, at least in the long term, should the response of currently high-spending

authorities to the increased pressures of local accountability.

3.13 Reducing the range in this way, in combination with the proposed new rebate scheme, may be enough on its own to answer any worries about regressivity. But if not, and if (despite 3.11 above) it were thought necessary to seek a remedy within the local tax structure, a variety of approaches could, at least in theory, be considered:-

- a more generous rebate scheme. This would of course involve reversal of recent Cabinet decisions on the housing benefit system (though the change from rates to residents' charge would have radically altered the context.) It would tend to reduce the pressure of local accountability and would add to the benefit caseload. It would also be costly, though there could be an offsetting reduction in the amount of per capita standard grant to authorities. This in turn would lead to a higher level of residents' charge, so that not only would the poor pay less but the better off would pay more.

- a graduated residents' charge eg supplementary benefit recipients would pay 20 per cent of the standard charge; others on low income or with no independent incomes 50 per cent; the rest, the full standard charge. We would need an additional grant to help authorities which stood to lose large sums as a result of the discount for low income groups; again we could pay for this by a reduction in the standard grant. Such an arrangement might be less damaging to local accountability than a more generous rebate scheme; but it would considerably complicate the administration of the residents' charge and would have something of the appearance of a local income tax. (See further Annex C).

- retaining the domestic rate, at a reduced level. The Government would set a national standard rate, or perhaps a maximum rate, well below today's level; the residents' charge would operate as a locally variable supplement. Providing we retained equalisation of domestic rateable resources through the grant system this regime would be less disruptive of household finances (the existing pattern of rate bills would remain). It would be more progressive within areas (richer people tend to live in bigger houses). But the system would be more costly to run than either rates or residents' charge on their own. Arguably, too, the residents' charge would on average be too low to achieve its objective of promoting local accountability; though its sensitivity to local variations in expenditure relative to assessed need would be increased. We would, of course, be running two unpopular taxes at once.

- an additional source of revenue. This too would reduce the average level of the residents' charge, with a similar loss of accountability. Candidates include an assigned proportion of a central tax such as VAT or Road Fuel Duty; or handing over to local authorities a tax such as Vehicle Excise Duty which they could set locally. The first would be tantamount to an increase in central grant (see below); the second poses difficulties of equalisation and would be less perceptible and less predictable in its yield than residents' charge or rates. No quite new local tax looks promising. (See further Annex I).

- increased central grant, financed by increased central taxation. This, coming on top of the 'nationalisation' of the non-domestic rate, would damage the 'localist' credentials of our

proposals.

3.14 While we do not believe any of these options should be ruled out at this stage, it is clear that none of them provides a straightforward answer.

C. TRANSITIONAL ARRANGEMENTS

3.15 Our first task is to modify our basic package, on the lines suggested above, in order to produce results which would be acceptable and defensible in the longer term. We cannot leave this job to transitional arrangements. Their role is rather to ease the introduction of changes which are accepted as necessary and desirable, but which will be disruptive in the short term.

3.16 We would undoubtedly need some such measures. But they have their dangers. They tend to be complex and would make it harder for people to understand what we were doing - and greater comprehensibility is of course one of our main aims. They might be taken to imply that we lacked faith in our own system.

3.17 That said, possibilities are as follows. Many variants on them could no doubt be devised.

(a) Changes in domestic tax burdens.

3.18 To smooth shifts between areas, we could have a safety net to limit to a specified percentage the inescapable combined effects of our proposals on the total domestic tax burden in the worst affected areas. These would generally be areas spending well above their assessed needs. The aim would be to give such authorities time to bring their expenditure more into line. We would pay them additional grant (paid for by a reduction in the level of standard grant) to offset the excess tax they would otherwise have to levy. The calculation would be based not on their actual budget but on their previous year's budget less a reasonable deduction. So the cost of demonstrably irresponsible spending behaviour would still fall on the residents' charge. The grant would be phased out over several years.

3.19 Additionally, we could phase in over, say, three years the reduction in Inner London's resource advantage. That would be at the expense of domestic taxpayers elsewhere.

3.20 To smooth shifts between households, the only workable arrangement we have so far identified is to phase out the domestic rate, and phase in the residents' charge, over several years. For example, authorities could be required to levy one-third of their domestic tax requirement through the residents' charge in the first year, two-thirds in the second year, and the entirety in the third year.

(b) <u>Changes in non-domestic tax burdens</u>.

3.21. Non-domestic rate bills would be affected, probably simultaneously, by two changes:-

- imposition of a national uniform rate and
- the proposed non-domestic revaluation.

The national rate will result in shifts <u>between areas</u>, in total non-domestic burdens. The revaluation will result in sizeable changes in the relative values of <u>individual properties</u>. Sometimes the two effects will offset each other. Sometimes they will reinforce each other.

3.22 We could if desired phase in the combined effects of these changes on the worst affected ratepayers over several years. We could pay for this by setting the national non-domestic rate a little higher than we otherwise would have done.

(D) <u>CONCLUSION</u>

3.23 The priority in our view is to modify our basic package in order to reduce the likelihood of unreasonably high average domestic tax burdens in authorities currently spending in excess of assessed need, particularly in Inner London.

3.24 Only when we see the effects of this work can we decide whether we can live with the regressive impact on households of the shift from domestic rates to residents' charge, as modified by the proposed new rebate scheme. If the answer is no, we should in the first instance look for remedies in the tax and benefit system as a whole, rather than risk blunting the impact on local accountability of our present proposals.

3.25. We have however identified a number of approaches which could be pursued within the local tax structure if desired - though none look straightforward.

3.26 Finally, once our package is in a form which is likely to give acceptable and defensible results for the longer term, we will need to devise ways of phasing in the more extreme changes. Again, we have suggested some possible approaches.

CHAPTER 4: CONCLUSIONS AND NEXT STEPS

A. CENTRAL RECOMMENDATIONS

4.1 Our central recommendations are for an integrated package of change consisting of:

(a) <u>a nationalised non-domestic rate and a lump sum needs grant</u>. This would end 'taxation without representation' for businesses and make the full impact of authorities' spending decisions bear on local residents;

(b) <u>abandonment of domestic rates</u> which are a highly unpopular tax, uneven in their incidence, and unsuited to the promotion of local accountability.

(c) <u>a residents' charge</u>. This would open up the way to the abandonment of domestic rates. It would widen the tax base to include almost all who lived in an area. It would stop domestic tax bills varying from area to area in line with the wide variations in house values. All adults would pay the same amount if their local authority was providing the same level of services.

4.2 We have looked at these recommendations from the point of view of:

- feasibility (see Annexes A-C)
- acceptability of effects, in both the long and the short term (see Chapters 2 and 3)

4.3 On <u>feasibility</u>, we conclude

- the changes in non-domestic rates and grant would be technically straightforward.

- the residents' charge would raise a number of new administrative and political issues. it would be harder and costlier to collect and enforce than domestic rates - particularly if it were graduated by income. But this is only a matter of degree. All taxes have their problems. Those of a residents' charge look to be surmountable.

4.4 On acceptability, the package will clearly need some modification. It is right that high spending areas should face high local taxes, but only to the extent that their excess spending is not justified by special local problems. We must therefore look again at our needs assessment methods generally. We must also develop the idea of channelling additional aid, with some Government control over its use, to the worst inner city areas. And we should leave Inner London with some of its existing resource advantage, in recognition of its special functions as the capital city. We shall also need transitional measures in the grant system to give high spending authorities time to adjust their expenditure. Such measures might also be necessary to ease the impact of a 'national' non-domestic rate and a non-domestic revaluation; and also - although this will be harder to achieve - the changeover from domestic rates to the residents' charge. The committee may also wish to modify the regressive impact of the residents' charge on households in some way. To avoid blunting the effect of the residents' charge on accountability we would prefer any such adjustment to take place outside the local tax structure altogether. But we have identified a number of possible approaches involving modification of our basic package, in case that route is preferred.

4.5 We clearly need to do much more work on, in particular, the technical details of the residents' charge; the modifications suggested in paragraph 4.4 above; and the effect these might have on the distribution of the tax burden between areas and households.

4.6 But we need to know first whether the Committee is content with our general approach, and in particular with our reliance on local accountability as the key to a healthier system of local government finance. Better accountability means making more of the electorate pay for local services. It requires a highly perceptible, and therefore unpopular, tax. It means a clearer relationship between local tax bills and the level of service the authority provides. It means making those bills more sensitive to local expenditure decisions.

4.7 If colleagues find this solution unacceptable, the only real alternative we see is for us to finance, in one way or another, a higher proportion of the cost of local services and to impose tighter direct controls over local spending in order to secure our macro- economic objectives. For the reasons set out in our introductory report, we consider such a course deeply unattractive both in principle and in its practical implications.

B. SUBSIDIARY RECOMMENDATIONS

4.8 A number of our recommendations, while related to our central proposals, are of second order importance. Decisions are not necessary at this stage, though we would be grateful for any preliminary views the Committee may have. These are:-

(i) Improved control on capital expenditure and borrowing (Annex E). We will circulate a further paper.

(ii) <u>Increases in fees and charges</u> (Annex F). We propose a Code of Practice on annual reviews of fees and charges, and liberalisation of as many as possible of those fees and charges currently set by the centre.

(iii) <u>Annual elections</u> (Annex G). On balance, we think it best for all authorities to be elected annually by thirds.

(iv) <u>Local authorities' budgeting framework</u> (Annex H). We are working up possible measures to promote 'sincere budgeting'.

C. CONCLUSIONS

4.9 The Committee are invited to agree

(i) that the central recommendations for change listed in paragraph 4.1 be taken as the basis for our further development work.

(ii) that we work up proposals to modify their potential impact on the types of authority and household likely to be most adversely affected; and the achievement of a smooth transition to the new system.

(iii) that we consider in further detail how the proposed residents' charge would best be administered, collected and enforced.

(iv) that we give further study to the subsidiary recommendations listed in paragraph 4.8.

4.10 We will report progress on all outstanding issues to the Committe in July, with a view to commissioning a White Paper for the Autumn. Meanwhile, we propose that we start <u>informal</u> consultations on our ideas forthwith. We need to start building up support for our approach as soon as possible.

ANNEX A

A NATIONAL NON DOMESTIC RATE

A: OBJECTIVE

1. Our main aim in recommending a national non-domestic rate is to remove the ability of local authorities to tap their non-domestic ratepayers for funds required to finance excessive spending. The cost of local authority spending increases would fall solely on local voters.

2. A national non-domestic rate could also help improve industrial location decisions by putting non-domestic ratepayers on the same footing in terms of rate poundages across the country. (Non-domestic rate poundages in Newcastle are nearly twice as high as in Croydon.) Greater certainty about future rate increases should create a better climate for forward planning by business.

B. SPECIFICATION

3. There are two quite separate operations.

a. <u>Setting a uniform national rate</u>

4. We could simply freeze non-domestic rates at their present levels. This would still limit the ability of local authorities to tap their non-domestic ratepayers. It would also avoid the need to increase non-domestic rates which lie below the national average. But the present inequitable pattern of non-domestic rate poundages and resulting distortions in industrial costs would remain in perpetuity.

5. We therefore recommend a uniform national rate (with transitional arrangements as necessary). In setting the rate each year, there would be clear advantages in involving both local authorities and business. We should consider the idea of setting up a consultative forum to make recommendations to the Government each year on the national rate. (Separate forums would exist for Scotland and Wales who could have different uniform rates.)

b. <u>Pooling the yield of the national average rate</u>

6. Inland Revenue would continue to keep a valuation list of all non domestic properties.

7. Each rating authority would pay the product of its non-domestic rateable values and the national average non-domestic rate poundage into a central pool. The proceeds of this pool would then be distributed as a fixed amount per adult across the country. There would therefore be 100% compensation for differences in non-domestic rateable values across the country. (Again, separate poools would exist for Scotland and Wales.)

8. It has been argued that if the yield of non domestic rates were pooled, there would be an insufficient incentive for authorities to maximise their collection. We do not agree. Three months before the start of the financial year, each authority would be informed of the amount it had to collect. (The product of the national non-domestic rate and its non-domestic rateable value as in the Inland Revenue valuation list.) If it failed to collect this amount, then the residents' charge would be correspondingly higher. We would, however, have to live with the fact that in the non-domestic sector we are turning local authorities from independent revenue raisers to tax farmers. As under the present arrangements there would be no incentive for authorities to maximise rateable values and many may correspondingly remain disinclined to grant planning permission. One way round the problem might be to allow authorities to keep say 5% of the yield of their non domestic rateable values. Alternatively, we could lag the effective date for rateable values, allowing authorities to keep the benefit of increased rateable values for say 12 to 24 months. Both ideas, together with ideas for protecting authorities with declining rateable values, need further consideration.

9. Our aim in the first year would be to set the national rate poundage to yield an amount broadly equivalent to the present yield, effectively harmonising on the national average. It would be <u>essential</u> to have a non-domestic revaluation, to ensure equity as between non-domestic ratepayers. It is still possible to have one and implement it in 1989/90, the earliest year we can introduce our reforms. There is no undue problem in isolating its effects within the non domestic sector.

B. RESULTS

10. The effects of setting a uniform national non-domestic rate and of pooling the yield of that rate are best considered separately:

a. <u>Setting a uniform national rate</u>

11. Table 1 isolates the effects of moving to a uniform national rate (and making no other changes). The main points are:

- i. businesses in low spending areas will face higher rates by up to 30%;
- ii. businesses in high spending areas (which include many of the northern conurbations) will face lower rates (by up to 30%);
- iii. domestic ratepayers in low spending areas will gain, because of the higher rates being contributed by their business ratepayers;
- iv. domestic ratepayers in high spending areas will lose, because their authorities will forfeit the (often very large) subsidies being given by their non-domestic ratepayers for excess spending.

12. The effects on businesses of a national non-domestic rate are likely to be dwarfed by the effects of a non-domestic revaluation. It is essential to have one if we are to keep non domestic rates. We shall, of course, be able to isolate changes within the non domestic sector. But the fact remains that the rateable values of e.g. city centre shops whose rents have shot up since the last revaluation in 1973 could increase very significantly.

b. Pooling the yield of the national non-domestic rate

13. If there were full compensation for differences between the rateable resources of local authorities, pooling the yield of non-domestic rate poundages would make no difference at all to authorities' income.

14. Because we do not have negative block grant, the City, Westminster, Camden, ILEA and the GLC are allowed to keep some of the benefit of their high rateable resources. The effect of pooling the yield will be a transfer of several hundred £ million from Inner London to the rest of the country.

C. IMPLICATIONS

15. There are likely to be four main fronts on which the proposal will be criticised:

a. Too much turbulence

16. Local people and local non-domestic ratepayers whose local taxes go up will complain that they are being hard done by.

17. Some of the sting of the change can be drawn by transitional arrangements. There are a number of possibilities. The simplest would be a freeze on all non domestic rates at or above the national average, leaving authorities with below the national average to catch up over time.

18. Another possibility would be simply to "cap" permanently non-domestic rates. The existing pattern of non-domestic rate poundages would remain. But each year, the Secretary of State would set a maximum percentage limit to increases. This would have the support of the CBI. Capping would make an important contribution to increasing local accountability by restricting the ability of local authorities to tap their non-voting non-domestic ratepayers. But we recommend this only as a very last resort. It would freeze the existing (and often unfair) pattern of non domestic rate poundages in perpetuity. (The pattern of actual rate bills would, of course, change once there is a non domestic revaluation.)

b. Non domestic rates no longer a local tax

19. Local authorities will complain that they no longer have control of their biggest single source of local revenue.

20. If the national consultative forum of local authorities and non-domestic ratepayers suggested at Paragraph 5 above is not considered a runner, one further possibility would be to provide that a forum of the local authority associations could be empowered to set the national non-domestic rates themselves. If they failed to reach (unanimous) agreement by 15 November each year, then central government would set the rate for them. This possibility is fraught with difficulties. Local businessmen are unlikely to view kindly non-elected bodies setting the level of one of their major tax burdens. And it would look like a Government cop-out.

c. Heavy losses for inner London

21. Local people and local authorities in inner London will all complain that they lose heavily and that it is quite wrong for them to retain no benefit at all from their high non-domestic rateable values.

22. No matter what financial regime is devised for local authorities, Inner London will not fit into it. The combination of extensive inner city deprivation, the enormous concentration of rateable resources in central London and the number of non-residents being catered for by inner London authorities will always ensure that.

23. Special arrangements will certainly be needed for Inner London. They will probably be needed for Outer London as well. The most straightforward is some "ring fencing". There are a large number of possibilities which we shall develop. They will inevitably entail some increase in complexity.

24. The introduction of a tax whose proceeds would benefit metropolitan areas - the most obvious is a "tourist tax" - would also help a number of inner London boroughs, as would targetted inner urban aid. These recommendations are considered elsewhere.

d. <u>No relation between non domestic rate bill and standard of service</u>

25. The Croydon businessman will complain that he is paying the same rate of local tax as the Sheffield businessman even though he receives a much lower level of service.

26. We could take some of the sting out of his complaint by increasing the fees and charges paid by individual non-domestic ratepayers to their local authorities. (At the same time we would reduce the overall level of non domestic rates.)

27. For services received directly (e.g. refuse collection and disposal, planning applications, environmental health services) this would be relatively straightforward. For services received indirectly (e.g. Fire, Police, Youth Training) the task is more difficult. We shall work up possibilities. One would be to deem that a specified percentage of local spending on e.g. Fire Services should be paid by non domestic ratepayers as a direct charge.

D. CONCLUSIONS

28. Do the Committee agree to:

i. a uniform national non domestic rate;

ii. pooling of the yield of the uniform national rate.

29. If so, do they want:

i. further consideration of special arrangements for London;

ii. further consideration of a local authority forum to set the national non domestic rate;

iii. further consideration of "deemed" fees and charges for services which cannot be charged directly.

ANNEX A
TABLE 1

Effects Of A National Average Non - Domestic Rate *

		1984/85 poundage **	Non - Domestic poundage %	Non - Domestic income £m	Domestic rate %
			Move to national average poundage		
			Change in		
		Col 1	Col 2	Col 3	Col 4
London High Spenders		£ 241.41p	£-25.77%	£-10.82m	26.16%
		£ 264.33p	£-32.21%	£-12.21m	24.24%
Thriving urban/ suburban		£ 156.27p	£ 14.67%	£ 19.31m	-18.33%
		£ 157.06p	£ 14.09%	£ 6.92m	-13.80%
		£ 160.57p	£ 11.60%	£ 2.27m	-18.18%
		£ 158.62p	£ 12.97%	£ 2.42m	-18.99%
Older northern industrial		£ 203.25p	£-11.84%	£-1.95m	12.13%
		£ 244.85p	£-26.82%	£-29.66m	45.09%
		£ 208.30p	£-13.98%	£-10.63m	17.91%
		£ 253.31p	£-29.26%	£-27.42m	40.53%
Shire districts in rural areas		£ 154.29p	£ 16.14%	£ 1.97m	-22.36%
		£ 156.95p	£ 14.17%	£ .45m	-9.75%
		£ 155.21p	£ 15.45%	£ .57m	-11.82%
		£ 160.31p	£ 11.77%	£ 1.15m	-15.56%
		£ 162.55p	£ 10.24%	£ .37m	-11.70%

* Assuming no other changes in the local government finance system

** Assuming : no use of balances (which artificially depress rates)
: no grant penalties

ANNEX B

A LUMP SUM NEEDS GRANT

A. OBJECTIVE

1. First, we want a grant structure which discourages at least as much as the present arrangements excessive spending by local authorities and which gives local authorities incentives to run their services economically and efficiently.

2. Second, we want a grant structure which continues to ensure that local taxpayers everywhere receiving a similar level of service pay a similar amount for it , despite the difference between their authorities' spending needs.

3. Third, we want to make the machinery for securing these first two objectives simpler and more intelligible and create a direct link between what an authority spends and what the local taxpayer pays.

4. We propose the replacement of block grant with a fixed grant to local authorities which compensates only for differences in their spending needs and does not vary with changes in their actual expenditure. This will:

i. increase pressure on higher spending (grant does not increase as an authority's spending goes up);

ii. promote economy (grant does not decrease as spending goes down);

iii. make the grant system significantly more comprehensible and accessible.

5. For the grant structure to achieve these aims, we will also need changes in the methods by which spending needs are assessed. We should aimfor both greater clarity, and stability from year to year, and greater sensitivity to extremes of local need. These aims may be difficult to reconcile.

B. SPECIFICATION

6. The table below shows how the 1984/85 Aggregate Exchequer Grant total would have been split under our proposals.

Present

Specific Grants	Block Grant		
	Needs Equalisation	Resources Equalisation and Per Capita	Domestic Rate Relief Grant
£2.6b	£4.6b	£3.5b	£0.7b

Proposed

Specific Grants	Needs Grant	City Grant	Standard Grant
£2.6b	£4.6b	?£0.7b ?	£3.5b

7. Under the proposed system local authorities would receive grant to compensate for differences in expenditure needs (the "needs grant"). On 1984/85 GREs we would calculate that might have taken up about £4.6 b of the £8.8 b rate support grant. It could well be higher under the revised system of needs assessment. We assume specific grants continuing at their 1984/85 level, and possibly an additional "city grant" to help inner city areas with special needs. We do not propose to alter the balance of funding betwen central and local government. So local authorities would receive the proceeds of the nationalised non domestic rate, distributed per adult, and a supplement to the needs grant, the "standard grant", again distributed per adult. The balance between the components of government grants - needs, specific and standard and the size of the city grant cannot be quantified at this stage.

(a) Needs grant

8. The needs grant would compensate authorities for differences in their assessed spending needs. The main causes of these differences are:

- demographic factors (e.g. numbers of school children);
- social and environmental conditions (e.g. elderly living alone);
- cost variations (e.g. higher London labour costs).

9. The needs grant would be paid as a lump sum to each authority, independent of its spending level. It would be calculated on the basis of authorities' assessed spending needs. The authority with the lowest spending needs per adult would receive no grant; all other areas would receive grant to compensate fully for differences in spending need per adult above the minumum. The result of paying needs grant in this way, when combined with our proposals for distributing a standard grant and the yield of non-domestic rates in proportion to adult population, is to enable a standard level of service (equivalent to spending need) to be provided in each area for the same rate of residents' charge.

10. We are not yet in a position to specify in detail how the method of needs assessment and its presentation might be changed. We shall face a sharp dilemma. On the one hand, we want greater simplicity and transparancy (as we did in 1980 when setting up the present GRE system). On the other hand since local tax rates will be far more sensitive than before to marginal differences between actual spending and assessed need the needs assessments will have to bear still more weight in the new structure than in the old. Much further work will be needed, and we are not in a position to say how successful we shall be in devising a system which is both simple and commands confidence.

11. Key areas we shall wish to address in the work we shall be doing include:

- The formidable <u>complexity</u> of the present needs assessment methods. This is the result of past efforts to reflect fully and fairly the factors necessitating local variations in spending to achieve common service levels. It would be a price worth paying if the results were generally accepted as fair. But they are not, and might never be, since "need" is and will remain a subjective concept.

- The apparent <u>insensitivity</u> of the formulae to extremes of local need. There is reason to think in particular that the special needs of inner cities, and the additional costs of services in London, are not adequately reflected in GREs.

- The <u>incomprehensibility</u> of the present formulae. Their apparent technical sophistication conceals many implicit value judgements about the weight to be assigned to special local factors. These need to be brought to the surface and made explicit. The way the formulae are presented, too, makes it hard to disentangle which parts relate to which services.

- The degree of <u>year to year volatility and uncertainty over grant entitlements</u>. This is because of detailed changes in the methodology from year to year, changes in the balance between the GREs for each service arising from decisions on the planned service totals in the Public Expenditure Survey, and revaluation of GREs after the grant settlement to take account of revised data.

<u>(b) City grant and standard grant</u>

12. Had our proposals been in force in 1984/85, there would have been £4.2b grant remaining on the assumption that we would have used £4.6 b of grant to compensate for differences in need. Annex D recommends additional aid to inner urban areas. If this recommendation is accepted, and we used say £0.7b (a notional figure at this stage) that would have left £3.5b as "standard grant" paid out as a flat rate per adult to all authorities. (Any grants that we might use to ease transitional problems would also come out of the amount remaining for "standard grant".) The distribution of standard grant (and also the yield of non-domestic rates) on a per adult basis would of course be particularly helpful to growing areas.

<u>(c) Specific Grants</u>

13. We assume that there will continue to be specific grants serving a variety of special functions e.g. to reimburse authorities for the bulk of their expenditure on services carried out as agents for central government and to promote new central policy initiatives. New specific grants might also be necessary to compensate authorities for any special needs which could not be adequately reflected in the national needs assessment formula. The range and form of specific grants required will need further study.

14. The scope and cash total of specific grants can be adjusted as necessary in the light of Departments' policy requirements. We would however resist an excessive expansion of such grants. Specific grants paid on anything other than a matching basis are costly to administer and too many grants would quickly undermine our basic objectives of maximising the accountability of local authorities for the services they provide.

C. RESULTS

15. The distributional effects of the needs grant will depend critically on the new system of need assessments. If judgemental factors have a greater role in needs assessment then <u>a wide range of outcomes is possible.</u> Depending on the judgements Ministers wish to make about the weighting given to social deprivation indicators (e.g. old people living alone, lone parent families) more/less needs grant can be allocated to urban areas.

D. IMPLICATIONS

16. There are likely to be four main fronts on which the proposal for a lump sum grant will be criticised.

a. <u>Unfair needs assessments</u>

17. If the judgemental content of needs assessment is increased, authorities who get less than they think they ought to receive will complain that their assessments are wrong/arbitrary/capricious.

18. The volume (in both senses) of such complaints will inevitably increase, certainly when the new system is established, given the greater importance of needs assessments in the new regime.

19. A simpler system with fewer variables would in our view however probably be easier to defend even though it attempted less exactness than the present system. There will however be no choice but to face out criticisms on the basis of the analysis underlying our new assessments.

b. <u>Wastes money on low spenders</u>

20. It will be argued that we are throwing away national taxpayers' money by compensating authorities for spending up to their assessed expenditure need even though they are not spending up to it. But it is key feature of our system that there should be a direct relationship between more economical service levels and lower local taxes.

c. <u>Less effective pressure on high spenders</u>

21. It will be argued that because the level of needs grant remains fixed regardless of an authority's spending, there is less pressure on high spending authorities to rein back their spending. (One feature of block grant is "negative marginal rates of grant" - where a number of high spending authorities <u>lose</u> grant as their spending increases.)

22. There is force in this argument if one considers the needs grant in isolation. But a fixed needs grant <u>and</u> a national domestic rate will mean that all the funding of extra spending will have to come from the residents charge. For every 1% extra spending the residents charge will have to go up by 4%. This is <u>more</u> severe pressure than provided by block grant for all but a handful of authorities.

23. A more refined version of the argument is that the present block grant machinery gives the government great <u>flexibility</u> in determining the impact on local tax levels of marginal changes in expenditure relative to GRE. The slope of the poundage schedule and the taper can be adjusted to provide any desired degree of disincentive or support for marginal spending. Our fixed needs grant would have none of this flexibility. 100 per cent of any difference between the authority's budget and GRE would fall on, or benefit, the local taxpayer at all expenditure levels.

24. We believe however that the loss of flexibility is a price worth paying for the greater clarity and simplicity of our proposed system. It achieves the sharpest possible distinction between the amount of expenditure the <u>Government</u> considers reasonable, with national taxpayers' money and the <u>authority's</u> own budget decision; and should encourage the voter to concern himself more actively with the latter.

E. CONCLUSION

25. Does the committee agree with the objectives set out in paragraphs 1-3? If so, does the committee agree that a lump sum needs grant meets these objectives?

26. Do the committee agree that we should do further work on

- the range and form of specific grants required?

- the methodology of needs assessment?

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Annex C

RESIDENTS'CHARGE

OBJECTIVES

1. The objective of a residents' charge is to improve local accountability by providing a more direct link between the use of and payment for local authority services than the present system of domestic rates. The basic proposal is for a flat rate charge, set by each authority, payable by every adult (over 18) resident in their area. The impact on low income households would be reduced by a system of rebates but (following the review of social security) every household would make some contribution towards the cost of the local residents' charge.

SPECIFICATION

2. The basic requirements for a residents' charge are:

- a system of identifying and registering all adults resident in rating authorities

- rules for determining and enforcing payment

- arrangements for rebating the charge to low income families.

The charge would have to replace at the maximum the total yield of domestic rates (£5.7bn gross of rate rebates, £4.5bn net in 1984-5). This is 40% of all revenue raised from rates, and 11% of local authority income.

REGISTRATION

3. Switching from an indirect tax on property to a tax on people (or their income) to finance local authority spending, necessitates the identification of people and their addresses.

No other tax levied in the UK requires this. The first requirement for a residents' charge would therefore be a register of all persons resident within each local authority area. No existing register of individuals offers a comprehensive and up-to-date listing of those residing in each authority.

4. National records such as those kept for social security and NHS registration do cover a high proportion of resident UK citizens across the country as a whole. But at present their information on addresses is often well out of date. Over 10 per cent of adults move house in the course of each year and the national systems do not require for operational purposes a full and accurate record of current addresses.

5. The Register of electors is the nearest to a comprehensive local list. It is compiled locally and up-dated each autumn. It uses a "qualifying date" - the 10th October - to confer the right to vote on individuals. The register using that date comes into force on 16 February of the next year. About 93% of individuals eligible to be included are correctly registered for the address where they resided on the qualifying date. However, that national aggregate conceals considerable variations between areas - the corresponding figure for inner London is only 86 per cent. There is also considerable variation between age groups (up to 17 per cent of under 30 years olds are not registered, at least for their qualifying address) and for ethnic groups (the corresponding figure is 30 per cent for New Commonwealth citizens). The Register is not amended to reflect movements after the qualifying date. So by the time it expires around 15 per cent of adults are no longer resident at the address for which they are registered. In addition, 7 per cent of individuals, included on the Electoral Register, are not eligible for inclusion, at least at their address shown.

6. An OPCS study concluded that it would be feasible to improve the existing canvass for the Electoral Register to provide a near comprehensive list of local residents, eventually getting close to the 99% coverage of the Census. This would demand a greater degree of personal canvassing than now and greater efforts to

follow up difficult cases. The current cost of keeping the Electoral Register is £23m. On OPCS estimatesthis could rise to over £30m. But this estimate was on the basis that few would wish deliberately to avoid registration since OPCS had found considerable public support for the idea of a general register. It would be prudent to assume a larger - and hence more costly - task to compile a register which was to form the basis of taxation, with corresponding incentives to avoid registration.

A NATIONAL OR LOCAL REGISTER?

7. The balance of advantage appears to lie with a local register. The main points are:

(a) the current rating authority (ie districts and boroughs in England and Regions in Scotland) would be responsible for establishing its own tax base - it would not be able to argue that the National Register was defective

(b) it would not raise the confidentiality and data protection problems of using a national register compiled for one purpose (eg access to a family doctor) for a different purpose entirely.

If the residents' charge is to be credible it will be important to minimise evasion. This suggests that non-registration should be made a criminal offence. A system of registration backed by the criminal sanctions will be bound to generate opposition on civil liberties grounds. This issue would have to be faced, however with any <u>local</u> tax on people rather than property or goods.

ONE REGISTER OR TWO?

8. The Electoral Register is an obvious model for the new register. But certain features of it make it unsuitable as the register for assessing liability to the residents' charge:

(a) it is based on a qualifying date and is not up-dated to take account of people who move between qualifying dates

(b) it excludes certain groups who should be registered for the residents' charge eg foreign nationals

(c) using the electoral register would act as a disincentive for people to register to vote.

For those reasons we have concluded that we need a separate register, with a separate duty on individuals to ensure thatthey are on the list of the authority in which they reside and to inform the authority when they move. This may well result in some individuals being less inclined to register for a vote because the Electoral Register will be used by the local authority in verifying registration for the residents' charge. But the greater resources devoted to compiling the register for the residents' charge should offer scope for improvement in the accuracy of the Electoral Register.

COLLECTION AND ENFORCEMENT

9. The responsibility for compiling the register and collecting the charge would lie with current rating authorities. Other authorities would, as now, precept for their income on the charging authority. We would need to establish a test of residence. This will not be simple. But we would expect to have regard to a person having an abode in an area, residing in some place in discharge of some duty or in compliance with some regulations. There would be a presumption that everyone was registered in at least one authority unless they could demonstrate that they were resident abroad. In order to ensure that some contribution was forthcoming from the 180,000 or so "second" homes in England, the authority would assume that every domestic property had at least one resident. Householders who owned more than one property in different local areas would be asked to register at least one resident in each property. It would be for the authority to try to establish that there were additional residents. The head or manager of communal establishments would be asked to register all the adult residents. The aim would be to have very few exemptions from registration (liability to pay is discussed below) but there would be some exemptions eg diplomats, merchant seamen with no permanent shore base.

10. A duty would be laid on the authorities to take all reasonable steps to ensure that the register was accurate and up-to-date. This would be in their own interest. Local authorities would be able to use other local records to identify people who were not registered such as:

- applications for housing and sale of property
- housing benefit claims for rent
- existing valuation records
- registration of children for school

There would be no question of denying a service once a person was found not be registered. The local authority, having identified someone who ought to be registered would simply put their name on the register, or in case of someone who contested registration, take legal proceedings. The register for the residents' charge would be kept up-to-date as people moved into or out of a local authority area. If an individual moved during the year he or she would inform the local authority he was leaving (to claim a rebate of tax already paid, or to discontinue instalments) and inform the authority of his new address. He would be under a duty to register with the new authority and would become liable to pay the proportion of the residents' charge for the balance of the year. After the canvass to compile the initial register for the first year of operation it would be for the local authority to decide whether it wanted to undertake canvasses every year or whether it would rely on the updating procedures. The choice would ultimately depend on the mobility of the local population.

11. There would be a new legal duty on householders to declare all those who are resident at a given address and a separate duty on individuals to take reasonable steps to ensure that they were registered. This raises two issues which it might not be possible to resolve fully until the scheme has been running for a couple of years. They are:

(a) who should be regarded as "resident". There is little case law on this at the moment, since few prosecutions are undertaken over failure to comply with electoral registration. It would fall to the Courts to interpret "residence"

(b) the extent of the problem of transients who may not be picked up without considerable administrative effort in some authorities with high concentrations of privately rented flats and bedsitters. If a large number of these people are claiming help with their rents from the local authority this could prove to be a "non-problem".

Such complications are inevitable in any system of local personal taxation. They are easier to deal with if a clear distinction is drawn between the duty to register and liability to pay.

LIABILITY FOR PAYMENT

(i) Private households

12. Paragraphs 10-12 recommend that we place a duty on the householder to register all adults resident in the household, whether or not they are dependant or related to him. At present, the householder is personally liable for the full rates bill, and it is a matter for him to decide whether or not to recover any part of it from other residents in the rateable property.

13. The purpose of the resident's charge is to extend the perceptibility of the effects of local expenditure policies. It would not be consistent with this to make householders liable for the charge payable by each resident in the household. It is reasonable however to treat the charge as a joint liability for couples, married or unmarried. This would fit with the rules that would apply for social security help. Separate bills or, if the administrative cost entailed were thought to be too high, itemised bills could still be issued to underline the basis of the charge.

14. A separate liability to pay would be placed on all other adults in the household with a separate source of income, including non-householders on supplementary benefit. This would have to be covered in the rules that would apply on assessing eligibility for rebates discussed below. Different arrangements would be required for adult members of a household (other than spouses or cohabitees) who are financially supported by the householder. Students are one obvious category. We need to consider further whether to exempt such categories from payment entirely or to deal with them through student grant/rebate arrangements.

(ii) Communal Establishments

15. The 1981 Census recorded 683,000 people as "resident" in communal establishments. Some of these are under 18 and hence would not be liable to pay the resident's charge. Table 1 illustrates the main types of such establishments and the numbers of residents, split between staff and "others".

Table 1 Residents in communal establishments *

(Thousands)

Type	Resident staff	Other residents
Hotels/boarding houses	49	35
Children's Homes	4	18
Old People's Homes	11	177
Psychiatric Hospitals	8	108
Other hospitals	27	63
Schools and colleages	9	17
Prison Dept. Establishments	0.1	17
Hostels/lodging houses	3	31
Other	6	99
Total	118	565

16. Under the present system some of these properties are rated as "non-domestic" (and may be eligible for relief if they are charitable foundations); there is no personal liability on any of the residents to meet the rates payment. Other properties, which belong to the Crown, will be assessd for a "contribution in lieu" of rates.

17. There are various approaches we can adopt to treating people resident in institutions for purposes of levying the residents' charge:

* 1981 Census definitions. These exclude short-stay prisoners.

(i) we can make all individuals liable, while continuing to tax the properties as "non-domestic", exempting certain categories of people (eg prisoners, mental patients etc)

(ii) we can exempt all individuals, other than staff, living in certain categories of institution eg psychiatric hospitals, prisons, old people's homes, and tax the institutions as non-domestic properties

(iii) we can convert the basis for taxing these institutions from rateable value to eg residential spaces and collect a "collective residents' charge" from the institution. We would not seek an individual contribution from residents.

18. The logic of the residents' charge is to exempt as few people as possible and to make as many people as possible individually responsible for paying the charge. So we should resist exemptions, as far as politically acceptable. But even if we decided to exempt all inmates other than staff of long-stay institutions we would only be exempting around ½m adults, out of a total adult population of 35m (about 1.4 per cent of the population).

Enforcement

19. Existing procedures for collecting rates would be applied to the collection of the residents' charge from individuals or heads of households, or managers of communal establishments who were liable for the charge. Non-payment (as opposed to non-registration) would not be a criminal offence. The local authority would continue to have discretion about enforcement of payment in cases of genuine hardship. Similar payment methods would be available for the residents' charge (i.e. half-yearly

payments or payments by 10 instalments) as are presently available to ease rate payments. People who move during the year would "deregister" for payment in the authority they are leaving and reduce their liability accordingly and would pay a proportion of the annual charge in their new authority.

20. Special consideration will need to be given to the procedures for dealing with highly mobile groups such as students and migrating workers and others who can claim residence in another area. But once an individual is registered the local authority can proceed against him for non-payment, unless he can show that he is wrongly registered in the authority and is paying the residents' charge elsewhere.

REBATES TO LOW INCOME HOUSEHOLDS

21. A flat-rate residents' charge on all adults will be a very regressive tax. If required to raise the income generated by domestic rates it would need to be set at about £160 per head. That is too large an amount to expect poor families to pay. So we have looked at the shape of a possible rebate scheme. The preliminary results of modelling the proposed new grant structure suggests that there will be large variations from this average particularly in Inner London. The implications of wide variations are discussed below. For clarity the initial discussions of what help might be available to households with low incomes assumes the average charge.

The Present Scheme

22. According to the latest local authority estimates over seven million households will be assisted with their rates bills this year at a total cost of about £1.4 billion (Great Britain)*. About 3.5 million households qualify automatically for a rebate because they are on supplementary benefit. Rebates to this group account for £810 million i.e. an average rebate of about £4.50 per week - £230 per annum. Another 3.8 million low income households who do not qualify for supplementar y benefit receive 'standard' housing benefit;that is they receive some assistance with their rates on the basis of a means test administered by the local authority. Rebates to this group total £570 million, on average £3 per week - £150 per annum.

23. The amount of rebate to households on supplementary benefit is determined primarily by the size of their rates. DHSS estimate that the rates for more than four fifths of these households are between £2-8 per week. Only about 7 per cent have rates of more than £8 per week. The amount of assistance given to households not on supplementary benefit depends on both the size of their rates bill and their weekly income as entitlement to benefit tapers off as income rises. About 20 per cent of owner occupiers currently receiving assistance have rates above £8 per week.

The Reformed Scheme

24. The reforms presented in the review of social security will reduce the numbers of households not on supplementary benefit who receive assistance with their rates by about 40 per cent. As a result the range of rates payable by the households who continue to receive assistance will be very similar to rates payable by households on supplementary benefit, that is over four fifths will be within the range of £2-8 per week. The

*All social security statistics are collected and presented for Great Britain as a whole. The figures used throughout the rest of the report are England only.

proposition that all households should pay 20% of their rates would mean that an average household on supplementary benefit would pay £0.85 a week - £44 per year.

The Effect of a Residents' charge with Rebates on Households in Supplementary Benefit

25. A charge which varies with the number of adults in the household will on average increase the losses caused by the proposals in the review of social security for all but single person households. As noted above the effect of the MISC III proposals on the household on supplementary benefit is to reduce their housing benefit rebate on average by 20 per cent - £44 per annum. The same proportion payable on a residents' charge of £160 is £32 per annum for the single person household and £64 per annum for a couple.

26. The position of the household with several adults on supplementary benefit is more complicated because non-householders who are not in work are eligible for supplementary benefit but not for housing benefit. At present however the supplementary benefit rates for a proportion of these non-householders (depending on their age) includes a contribution towards their housing costs. An extension of these provisions would help protect such households. Where a householder on supplementary benefit has living with them an adult earner, the earner would be liable quite separately for the full charge. This would bear heavily on low earners particularly young adults in low paid employment living with their parents.

27. We conclude that it would be possible to produce a workable rebates scheme following the review of social security for households on supplementary benefit if the range of the residents' charge was not much more than the £160 average.

The Effect on Other Low Income Households Receiving Assistance with Rates

28. The reformed structure of housing benefit would assess entitlement to benefit on the basis of the combined sum payable by a household for both rent and rates. The basic steps will be:

i. Assess the maximum benefit payable if net income is equivalent to the appropriate supplementary benefit scale rate for that household. This is 100% of rent and 80% of rates.

ii. Reduce the benefit payable by a fixed proportion (70 per cent) of the amount by which actual net income exceeds the appropriate supplementary scale rate.

29. This is a much simpler assessment than in the current housing benefit scheme. Moreover basing entitlement to benefit on net rather than gross income places an upper limit on the 'marginal tax rates' experienced by low income families paying both rent and rates. At present such families can lose the whole of a pay increase through paying more in tax and national insurance as gross income rises and at the same time have their entitlement to benefit reduced. The single rate of withdrawal of benefit, as net income rises, applied to both rent and rates obviously has a much sharper impact on those households who only pay rates. At present such households can receive help further up the income scale because a much shallower rate of withdrawal is applied to rates than to rents.

30. The logic of combining assessment of entitlement to benefit on rent and rates is less clear if rates are replaced by a residents' charge. It would have the effect also of obscuring

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increases in the charge. But combined assessment allows a sharper rate of withdrawal of benefit from all households with net incomes above supplementary benefit. At the same time it puts an upper limit on the 'marginal rates of tax' for those households receiving assistance with both rent and rates. Reverting to separate assessment with a slower rate of withdrawal would mean forsaking some of the public expenditure and caseload savings in the social security review.

31. As with households on supplementary benefit all the issues are much more easily dealt with if a residents' charge can be set relatively low.

32. We conclude that if charges did not much exceed £160 per adult, the results could be made tolerable with a rebate scheme along the lines agreed in the review of social security. It might be possible to run the scheme with no specific rebates for residents' charge but some cash adjustment to social security rates if the charge was set quite low, for example a maximum of £50 per adult. A theoretical half-way house would be a scheme which provided a standard rebate of a proportion of the charge for households on supplementary benefit and other specified groups, for example, households currently receiving Family Income Supplement. Because of the effect this would have in deepening existing poverty traps this could only be considered if again the charge was set low, well below the £160 average.

A GRADUATED RESIDENTS' CHARGE

33. An alternative to providing a rebate scheme for benefit and low income households would be to take account of ability to pay in determining initial liability to the residents' charge. This could also take account of higher incomes, and family circumstances eg non-earning dependents. A possible scheme would

differentiate between incomes in deciding the proportion of the charge individuals in different circumstances should be asked to pay, with people on benefit paying the lowest rate and people on low or no independent incomes paying a reduced rate. By making better off people pay more, and hence reducing the amount low income households have to find, for any given total yield of the residents' charge, it could bear greater weight without the need for greater reliance on rebates than now.

34. With a lot of bands this could begin to look like a local income tax although the charge paid would not increase within the bands. If the scheme were based on previous year's income it should be possible to base tax liability on a declaration by the individual. It would be important for accountability to have the charge administered by the local authority, not integrated with the collection of national income tax or National Insurance contributions.

35. There are some obvious advantages - but such a scheme would be harder and more costly to administer than a flat-rate scheme; it would cause additional confidentiality problems as the local authority would need to check a sample of declarations made, and it would create poverty traps at each threshold. We would also need to compensate authorities with above average numbers of benefit recipients and people on low incomes, introducing a new complexity into the grant system.

ANNEX D

TARGETED AID FOR INNER URBAN AREAS

A. OBJECTIVES

1. Inner city authorities tend to spend much more than their assessed spending needs. To varying degrees, this is because of:

- expensive policies of which the Government disapproves;

- endemic inefficiency and waste;

- acute, increasing and intractable problems of multiple deprivations.

2. We want to squeeze out the extravagance and waste. But we are also seeking more effective targeting of help for the deprived. The problem is how to achieve both at the same time.

3. Our main proposals would provide a tighter discipline on overall local authority spending than the present system. Spending in excess of assessed need would be met in full by local residents. And all of them, including the poor, would make a contribution to local service costs.

4. The inner city authorities would not however be able to bring their spending down to assessed need overnight. Initially, then, the inner city poor would be much worse off. They would in addition suffer a more permanent loss in London, where we propose to remove some or all of the authorities' resource advantage.

5. In the longer term, we would expect the authorities to spend less; local tax bills would then come down. But unless they also spent more sensibly and efficiently, services to the deprived would get worse. The authorities' ability to tackle their problems of physical decay, and to work with the private sector in urban renewal would also be reduced.

B. SPECIFICATION

6. The first step is to consider whether our proposed disciplines may not in their present form be too harsh on the inner cities. Had our tax and grant proposals been operative in 1984/85, the domestic tax burden in partnership and programme authorities needed to finance their budgets would have been approaching £600 million higher.

7. Elsewhere, we recommend review of our present methods of needs assessment, consideration of special arrangements for London, ands possible measures to reduce the impact of residents' charge on the poor. (Chapter 3, Annexes B, A and C). We suggest also a transitional grant (Chapter 3) to give high spending authorities time to bring their expenditure down to their assessed level of need. All these measures should help the inner areas.

8. There are arguments for leaving it at that. If the new needs assessment resulted in a smaller initial gap between inner urban authorities' actual and desired expenditure, then a correspondingly smaller burden would fall on the domestic taxpayer. Transitional grant would protect the taxpayer until the gap was closed. We would then leave it to local pressures and, in matters of major national policy interest, the operation of specific grants, to ensure that the authorities made more sensible and effective use of their reduced budgets.

9. But that would still leave us with three problems:

- while we hope to improve our needs assessment methods, it is doubtful whether any general formula would be able to reflect adequately the special problems of the deprived, and the difficulty and expense of delivering services to them, in the worst inner city areas;

- the worst inner areas are unpromising terrain for the revival of healthy local democracy we are seeking. Population is highly mobile, election turnouts low, authority is widely distrusted and disliked, and political partisanship extreme;

- whilst some of these authorities are doing a good job in very difficult circumstances, the performance of others is desperately poor: calibre and moral of members and officers is low, overmanning and restrictive practices are rife, political extremism is a growing threat.

10. So these authorities may need at least the help they get now and possibly more if their residents are not to face unreasonably high bills and their problems are adequately to be tackled. But we cannot trust all of them to spend even the grant available now wisely - let alone any extra resources. Their local democracies are, in any case, weak and further weakened by the transfer to them of large sums of other peoples' money without strings. No local voter can be expected to understand the extent to which central government is silently supporting his authority; his council is hardly likely to tell him. Central government needs to put its own democratic weight into the balance to show that it cares about the inner cities and is willing explicitly not only to help, but also to make it clear whose voters are responsible for which parts of the financing of local spending.

11. We therefore think we must consider some form of additional selective aid to the inner cities, possibly by means of a new "city grant" financed from the existing total of government grants to local authorities. Mechanics will need much more thought. A crucial question here is what scale of operation would be required and this we cannot tell until we know how far the potential effects of our main proposals on domestic rate bills in the inner areas are likely to be offset by refinements to the needs assessment. But in essence, we would ask the authority to propose a programme of additional spending, up to a speficied amount, aimed at improving the cost-effectiveness of its main services. This would be discussed with the Government and, to the extent that it was found acceptable, would attract an additional lump-sum grant.

12. The new scheme would seek directly to influence local authority main spending programmes. This would be very different ground from that covered by the urban programme, which supports specific projects outside the mainstream of local authority activity. Existing partnership arrangements might nonetheless provide a starting point for setting up the new machinery.

C. IMPLICATIONS

13. If colleagues agree that the effects of the rest of our package will necessitate additional selective aid to the inner city areas, they must recognise that a substantial increase in government effort will be required. This poses very considerable problems for the traditional relationship between local and central government. Care would be needed to ensure that extra help did not further undermine what strength is left in inner city democracy. Our aim must be to secure maximum leverage from our input of additional resources on authorities' delivery of services without becoming enmeshed in local politics or incurring the blame for authorities' shortcomings.

D. CONCLUSIONS

14. The exemplifications in Chapter 2 suggest that our main proposals will be unworkable unless their potential impact on the inner cities can be substantially reduced. This can be done to some extent - we do not yet know how far - by changes in the needs assessment, in the treatment of London, and by transitional grant to give the authorities time to scale down their spending.

15. But this may not be enough. Nor does it address our worries that the 'localist' approach we are advocating will not work in the special conditions of the inner cities; and that, for all the money the authorities are spending, many of the inner city deprived are still getting a raw deal.

16. We therefore see a strong case for some form of additional aid, aimed at securing improvements in the functioning and efficiency of main services. But the machinery needs to be thought about further, in consultation with other interested Departments.

ANNEX E

CONTROLS OVER CAPITAL EXPENDITURE AND/OR BORROWING

A. OBJECTIVE

1. A new and consistent framework is required for local authority capital expenditure which will:

a. provide a more secure form of control over local authority borrowing whether directly or through controls over capital expenditure;

b. give better incentives for local authorities to sell underused assets and generate operational savings;

c. offer more predictability and stability in the level of capital spending by local authorities, both individually and in aggregate.

B. SPECIFICATION

2. Local authority borrowing can be controlled directly, thus influencing the level of capital expenditure, or indirectly, through controls on the capital expenditure to which the borrowing relates.

3. Five basic options have been drawn up in discussions between Government officials and officers of the local authority associations. Three relate to the direct control of local authority borrowing and two to control of capital expenditure:

a. New borrowing for capital purposes This is the option preferred by the local authority associations. For each authority, a borrowing limit would be set, against which all "borrowing" for new capital expenditure in the year would count, whether raised externally (e.g. from the temporary investment of surplus revenue cash). The limit could be supplemented by whatever sources were available (e.g. capital funds or contributions from revenue) and this option offers less control than the remaining options.

b. Net external borrowing for capital purposes Under this option, borrowing limits would be set for each authority, against which all external borrowing for capital purposes would count. This would include external loans raised to refinance spending previously financed from the temporary investment of surplus revenue cash.

c. All net external borrowing Under this option, for each authority all external borrowing would be controlled, whether for capital purposes or temporarily in anticipation of revenue income.

d. Net capital expenditure This is a refinement of the present system which aims to control capital expenditure net of capital receipts from sales of assets during the year in question.

e. Gross capital expenditure Under this option, capital expenditure would be controlled against gross spending ceilings for each authority, ignoring variations in in-year capital receipts. To maintain an incentive for asset sales, local authority capital receipts could be taken into account in constructing future years' limits.

Variations around these basic options are possible.

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4. We are not yet in a position to choose between these options, but we would prefer a framework which by giving central Government better control over the aggregates at which the system is directed, reduces the uncertainty caused at present, inter alia, by local authorities' ability to use the £5 billion "overhang" of accumulated capital receipts derived from recent asset sales, which unless restricted adds to the PSBR. By contrast use of in-year capital receipts and revenue contributions has no direct effect on PSBR.

C. RESULTS

5. A simplified "Which"-type assessment of the five basic options is included in the attached schedule. It assesses how each option performs against six basic objectives. None of the options satisfies all the objectives. Indeed there are inherent tensions between flexibility and stability which are unlikely to be resolved under any option. We cannot offer a "best buy" until there is agreement on the relative importance of the different objectives.

D. IMPLICATIONS

6. The options are very different in kind. Those which seek to control expenditure are, to different degrees, developments of the present system. Those which seek directly to control borrowing have much wider implications and, except in the case of the local authority associations' proposals, impinge on the revenue side. The option finally chosen will have to be consistent with the proposed current expenditure regime.

7. Local authorities will be sensitive about any reduction in spending power or felxibility through elimination of the "overhang" of capital receipts. Greater use of in-year capital receipts and revenue contributions, whilst protecting the PSBR, would go a long way towards offsetting this, particularly when combined with the proposed regime for current expenditure. Flexibility in the use of in-year capital receipts and revenue contributions would also answer the Audit Commission's criticism 84.

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that there is insufficient incentive to generate operational savings through efficiency drives. But such measures would affect control of aggregate capital expenditure.

8. The Audit Commission also criticised the absence of a firm three to five year planning horizon and excessively detailed central control over local programmes and projects. Some progress has been made in this direction, and any further relaxation would have to be reconciled with the Government's responsibility for managing the economy and the duties of Secretaries of State in relation to their own spending programmes.

E. CONCLUSION

9. A new framework is required for the control of capital expenditure or of borrowing which delivers total figures closer to national plans and which gives individual authorities greater certainty about the available level of resources within which they can plan capital programmes over several years. There would be attractions in principle in operating the new control on net external borrowing by local authorities and giving authorities the freedom to spend in addition on capital in any year any amounts they choose locally to raise by asset sales within the year or by revenue contributions. There are however practical problems in devising such a system. These are being explored further. In the event, some form of capital expenditure control, (perhaps based on gross expenditure) might provide the necessary degree of influence over borrowing and be more practicable for early legislation. A separate paper would be circulated on the range of options shortly.

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ASSESSMENT OF OPTIONS AGAINST BASIC OBJECTIVES

OPTIONS	Will the option restrict divergence from centrally planned levels of borrowing?	Will the option restrict divergence from centrally planned levels of expenditure?	Will the option provide an adequate incentive to generate capital receipts?	Will the option allow authorities to prepare sensible capital programmes?	Will the option prove workable, without undue transitional problems?	Will the option prove simple and equitable and promote efficiency?
Control over borrowing for capital purposes	Limited influence: Externalisation and revenue borrowing uninfluenced ●●	Very Limited influence: Free use of all receipts, RCCO, etc. ●	High incentive: Complete freedom to spend receipts as addition to loan finance at any time. ●●●●●	Uncertain: Sufficient additions to controlled element to smoothe over much fluctuation in provision - but attempts to improve control could make fluctuations severe ●●●	Good: Existing receipts would remain available so far as backed by cash ●●●●	Potentially good, but: attempt to tighten control could restrict allocations to level where it is difficult to deal equitably with spending need ●●●
Control over net external borrowing for capital purposes	Moderate influence: Revenue borrowing still not influenced; influence over borrowing for capital not in practise complete ●●●	Moderate influence: Free use of in-year receipts and RCCO, but overhang of accumulated receipts no longer a problem ●●●	Moderate incentive: Free use of in-year receipts; possibility of reflecting in-year receipts in allocations ●●●	Moderately good: System would offer more stability than above, while RCCO and receipts would still provide some flexibility. ●●●	Poor: May be unworkable; in any case expected resources from accumulated receipts completely cut off; introduces inefficiency into authorities financing ●	Moderately good: Likely to be less vulnerable to above objection ●●●
Control over all net external borrowing	High influence: Theoretically guaranteed to be within limit, though some tolerance would be needed in practice ●●●●	Moderate influence: As above, but with potential for undershoot if authorities give preference to current spending ●●●	Limited incentive Free use of in-year receipts; but more difficult to reflect accumulated receipts in setting limits ●●	Moderate: As above, but potential cash-flow problem ●●●	Fairly poor: Similar to above, but more likely to prove workable without great inefficiency ●●	Fairly poor: Very complex to set limits and arrange suitable safety valve ●●
Control over net capital expenditure	Moderate influence: Similar to first option above, but revised system would probably limit use of accumulated receipts and so deter externalisation ●●●	Only moderate as operated, but: could be much better at price of internal cut off of receipts as in Scottish system ●●●	Moderate incentive: Some use of receipts for at least a period of years ●●●	Fair: Revised system could be more stable than present system, but at price of reduced flexibility e.g. on use of receipts ●●	Moderately good: No immediate cutting off of receipts ●●●●	Fair: Could be better than now under a revised system, but difficult to avoid some of the same pitfalls ●●●
Control over gross capital expenditure	Moderate influence: Slightly better than previous option ●●●	Good influence: better than previous option, because not affected by fluctuations in in-year receipts ●●●●	Limited incentive: No free use of receipts, but possibility of reflecting accumulated receipts in allocations ●●	Fair: Slightly better than previous option ●●	Fair: Accumulated receipts cut off but could be reflected in allocations ●●●	Fair: As above ●●●

Notes

RCCO = Revenue contribution to capital outley.
Externalisation = External borrowing to re-finance spending previously financed from the temporary investment of surplus revenue funds.

Annex F

INCREASED FEES AND CHARGES

A. OBJECTIVE

1. Charging for services, where possible, is desirable because
   (a) it promotes accountability
   (b) it provides a more efficient means of allocating resources between services, in line with consumer preferences
   (c) it reduces the amount of revenue required from local and/or central taxes

2. Additional income of between £200 million and £500 million could be raised, over a period of time, if authorities were more active in seeking to maximise income from existing fees and charges.

B. SPECIFICATION

3. The following measures would create a greater awareness of the potential for increasing income from fees and charges, and at the same time provide the necessary incentives:
   (a) a statutory requirement on local authorities to conduct an annual review of their fees and charges in accordance with a Code of Practice. The code would cover the principles to be adopted in pricing decisions and the accounting arrangements which would be necessary to identify true costs and subsidies. It would be drafted by CIPFA.
   (b) a clean sweep of all statutorily determined fees and charges, with a view to transferring as many as possible to local discretion. Almost 100 charges are determined by central government, either precisely or as maxima. Most relate to the granting of licences for matters as diverse as donkey driving and shotguns.
   (c) an overall grant system which ensures that increased income is not offset by grant reductions (as at present). The lump sum needs grant will achieve this.

	Fees and Charges as a % of 1983/84 Rate Fund Revenue Expenditure		
	Class Minimum	Class Maximum	Class Average
Metropolitan Counties	1% (S. Yorkshire)	3% (Tyne + Wear) (West Yorkshire)	2%
Metropolitan Districts	5% (Bury) (Rochdale) (Sefton) (Knowsley) (Calderdale)	16% (Wigan)	7.8%
Non-Metropolitan Counties	4% (Derbyshire)	8% (East Sussex)	5.8%
Non-Metropolitan Districts	4% (Hartlepool, Cleveland) (Wear Valley, Durham) (Leominster, Hereford and Worcester) (Cannock Chase, Staffordshire) (Babergh, Suffolk) (Epsom and Ewell, Surrey)	29% (Colchester)	11.4%
Inner London Boroughs (excl. City)	5% (Lambeth)	17% (Westminster)	9%
Outer London Boroughs	1% (Havering)	16% (Kingston)	8.4%
GLC (inc. ILEA)			6.2%

C. RESULTS

4. Local authorities finance just under 7% of their total rate fund revenue expenditure by way of income from fees and charges. In 1983/84 this amounted to around £2 billion.

5. This average of 7% conceals a wide range, within each class of authority, as the table above indicates.

6. If those authorities performing below average for their class moved up to average, an additional £200 million would be raised. It might be possible to increase this sum to £500 million, over time, if all authorities improved their performance so that the average recovery rate moved up to around 9%.

D. IMPLICATIONS

7. Securing an extra £200 million from the existing range of fees and charges cannot be guaranteed. Over half of the income from fees and charges is raised through charges controlled or strongly influenced by the Government (e.g. residential accommodation for the elderly) or agreed between local authorites collectively (e.g. further education tuition fees and payments for pupils educated in neighbouring authorities). In the latter case, increases in income for some authorities, from higher fees, would be matched by increases in expenditure for others.

8. To some extent the variations in recovery rates reflect the special circumstances of individual authorities and their political control. As a matter of policy, some authorities will choose to encourage use of facilities, often by disadvantaged members of the community, by holding down charges and, if necessary, allowing deficits to increase. Others will not wish to court public hostility by seeking to increase locally sensitive charges such as those for car parking or burial and cremation.

9. It would be possible to place more specific and detailed requirements on local authorities to overcome these difficulties. The following are examples:

(i) a requirement that a "reasonable" charge should be levied in each case. There are clear problems of definition here, which would probably lead to litigation. The results might not be in favour of increased income.

(ii) a financial regime requiring separate accounts and a specific return on capital or level of cost recovery. Given the administrative difficulties, it would only be worth doing this for a relatively small number of services. This would necessarily limit any extra yield.

It would also be insensitive to local circumstances (e.g. market conditions or mix of facilities). Our view is that these latter possibilities are better dealt with selectively in a Code of Practice than through separate all-embracing regulations.

The Scope for Income from new Charges.

10. There are two possibilities which would secure more than an extra £500 million from fees and charges. First, charges could be extended to cover services currently provided free. Such services might include:

- nursery education (cost £110 million in 1983/84)
- libraries (£365 million)
- museums and art galleries (£65 million)
- fire (£574 million)
- refuse collection and disposal (£671 million)
- free school meals (notional deficit of around £150 million p.a.)

Substantial income could be generated. The proposals would be highly sensitive. They might conflict with existing central policy objectives where it is in the interests of the community that the service should be consumed (eg. refuse disposal, fire protection). They might also require an extension of means testing and concessionary charges. The practical implications would require careful evaluation.

11. Second, it might be possible to devise a method by which non-domestic ratepayers could be charged directly, by authorities, an appropriate proportion of the costs of the services from which they directly benefit, such as highways, street lighting, youth training, police and fire. The national non-domestic rate could be reduced by an appropriate corresponding amount. In the case of the police and fire services, it might be possible to link this with a degree of freedom on the part of the non-domestic ratepayer to obtain the service elsewhere. This is on the face of it, an attractive option in that it could strengthen the local link between

what the non-domestic ratepayer receives and what he pays for, which will otherwise be absent under the proposed national non-domestic rate. It could, however prove very complex to devise such a scheme. There would be significant practical difficulties (e.g. the calculation of the attributable charge to a firm for police services). Again, the proposals would need to be checked for consistency with central policy objectives on community consumption.

E. CONCLUSIONS

12. We recommend:

(i) a Code of Practice on annual reviews of fees and charges by local authorities

(ii) a clean sweep of all statutorily determined fees, to transfer as many as possible to local discretion.

13. Extending fees and charges to services currently provided charge free and to non-domestic ratepayers requires major, and prior, policy decisions. We can assess the practicalities of each in the light of the Committee's views.

ANNEX G

ANNUAL ELECTIONS

A. OBJECTIVES

1. The objective is to build on our other recommendations which are designed to promote local accountability by creating a consistent and comprehensible local electoral pattern which will call all local athorities to account at frequent intervals.

B. SPECIFICATION

2. The proposal is that, in future, all authorities in England should be elected by thirds each year, and that members should each serve a three-year term. Local election policy in England is however the responsibility of the Home Secretary; his position is fully reserved.

3. At present, most local authorities are elected as a whole every four years. However, metropolitan districts and those non-metropolitan districts which have chosen to do so have annual elections (except in the year of the county elections) by thirds. All local authority members serve a four-year term (except where an authority is in the process of changing over from whole council elections to elections by thirds).

4. In metropolitan districts, all wards are represented by three members, retiring in rotation. Consequently, every elector has the opportunity to vote in each district election. But that is not so elsewhere. County councils have one-member electoral divisions. Non metropolitan districts and London boroughs mostly have a mixture of one, two and three-member wards.

5. On the present electoral map, election by thirds could therefore be introduced only in an "impure' form. In the counties, each elector would be able to exercise his vote only once every three years. In the non-metropolitan districts and boroughs, the frequency of the individuals' voting rights would depend on whether his ward was represented by one, two or three members. But in all cases, of course, the council's record would face an annual test at the polls.

6. Redrawing the electoral map to create three-member divisions and wards everywhere, and thus to allow introduction of "pure" election by thirds, would take five to six years (unless Boundary Commission resources were greatly increased). Arguably, this would be both unnecessary and undesirable in the counties. Here the "impure" system would at least be consistent and comprehensible in terms of voting rights. And amalgamating the existing single member divisions to form three-member ones would create unmanageably large areas in the rural counties.

7. Neither of these factors applies in the non-metropolitan districts and London boroughs. In the longer term, therefore, it would be preferable to create three-member wards throughout these authorities, since otherwise voting rights will vary from ward to ward in an anomalous and confusing way (this is already the case in most of the districts that have opted for elections by thirds). If limited to the lower-tier authorities, this operation need take only four to five years.

IMPLICATIONS

8. There are likely to be two main fronts on which the proposal will be criticised.

a. No improvement to accountability

9. It can be questioned whether any change in the local electoral pattern would significantly improve accountability, given the strong influence of national politics on local election results and the traditional domination of many authorities by a single political party. For these reasons, an inter-Departmental study in 1982 concluded that none of the possible changes considered would be worth the cost and disruption.

10. Against this there is some reason to think that the importance of local factors in local elections has been underestimated in the past, and has been growing; and that traditional party allegiancies have been becoming less strong. Besides, our other recommendations for increasing the proportion of local electors that contribute towards the cost of local services, and for increasing the impact on local tax rates of variations in service levels, should encourage the voter to pay more attention to the spending behaviour of his authority. We believe that, in these changed circumstances, electoral reform has a contribution to make to the promotion of local accountability.

b. Practical difficulties

11. It can also be questioned whether, assuming the desirability of a more uniform electoral pattern, universal election by thirds is the best pattern to opt for. It can be argued for example that:

- authorities faced with an annual electoral test will be unwilling to pursue policies of long-term benefit involving short-term controversy, for example rationalising school provision as pupil numbers fall;

- in marginal areas, constant shifts in the balance of power make sensible planning and responsible decision-taking impossible;

- a council's record is easier for the voter to judge if it is elected as a whole and left in power long enough to carry through its policies - say, at least three years;

- if asked to vote too often, the voter will lose interest;

- annual elections by thirds would add significantly to the public expenditure involved: on 1982 estimates, about £50 million over a four-year cycle, and another once-for-all £5 million if the electoral map were re-drawn. Parties' and candidates' costs would also increase;

- the original intention of local government reorganisation was that <u>all</u> non-metropolitan districts should elect by thirds. But this proposal was dropped following Parliamentary pressure. We could expect fierce resistance if we were now to revive it, and to extend it to counties and London boroughs.

12. If these arguments were thought to be conclusive, it would be preferable to opt for whole-council elections for all authorities perhaps every three years.

13. A major factor in favour of universal elections by thirds, however, is that it would put a stop to the widespread practice in councils elected as a whole of setting an artificially low rate in their election year, and thus seeking to mislead the electorate about its spending behaviour. A comparative study of the rating decisions of county councils (then elected as a whole for a three year term) and districts and boroughs (then elected annually by thirds) in the period 1950/51 to 1973/74 showed that the counties rate-call increase in election years fell consistently below the long term trend by an average of 6%, rising more steeply in the following year so as to restore the trend.

14. Comparison of the rating behaviour of non-metroplitan districts elected as a whole and by thirds in the period 1981/82 to 1985/86 shows a similar pattern: the "whole" authorities increased their rates by significantly less than the "thirds" authorities in their election year, and by significantly more in the preceding and succeeding years. Manipulation of this kind can only serve to undermine our efforts to promote a healthier local democracy.

15. Additional arguments in favour of universal elections by thirds are:

- the need to account to the electorate every year would provide an important safeguard against the pursuit of extremist policies for which the council has no clear mandate;

- the combination of annual elections and three-year terms for individual councillors ensures that at all times there is a substantial pool for experienced members;

- where local political opinion is finely divided it is all the more important that it be tested annually, whatever the problems frequent changes of control may pose for council officers.

D. CONCLUSIONS

16. On balance, we consider that the arguments in favour of universal annual elections by thirds outweigh those in favour of the status quo and of universal whole council elections.

17. Again on balance, in "impure" system based on the present single-member electoral divisions would seem preferable in the counties. In the districts and London boroughs, the "impure" system should be introduced only as a short-term expedient, pending the creation of three-member wards throughout these areas.

18. These recommendations relate to England. But, <u>mutatis mutandis</u>, they seem equally applicable to Wales and to Scotland (which, however, has single-member divisions and wards in <u>all</u> authorities).

ANNEX H

OVERHAUL LOCAL AUTHORITIES' BUDGETING FRAMEWORK

A. OBJECTIVE

1. The objective is to restrain deficit financing and "fudged" budgeting, so that the relationship between local tax levels and local spending levels is not obscured.

B. SPECIFICATION

2 The unprecise nature of local authorities' budgeting framework has cut across the Government's efforts to restrict local government expenditure since 1979. Three major problem areas have been identified:

a. the use of balances and reserves to obscure the relationship between local tax levels and local spending. Evidence suggests that local authorities with four year electoral cycles tend to have lower rate rises immediately before an election than those with annual elections;

b. creative accounting to avoid grant penalties for exceeding targets, and to avoid reducing real expenditure;

c. deficit budgeting, or the threat of it.

3. The proposal to hold annual elections and the abolition of targets will effectively eliminate the need to take action on (a) and (b). The threat of deficit budgeting, or "fudged" budgeting, is more likely to remain, however, particularly in the more extreme authorities. We therefore propose:

A legal requirement to preare a "sincere" budget The Audit Commission would selectively vet proposed budgets, in response to certain "triggers". An authority subject to vetting would require an audit certificate stating that, in the aduitor's opinion, the budget proposals (including the local tax levy) would provide sufficient income to cover the level of expenditure which the authority was likely to incur, given its intentions. Failure to obtain the necessary certificate would prevent the authority setting its local tax rates.

An authority which then refused to amend its budget could be compelled to do so through the Courts. Alternatively it could be allowed to continue to operate, but without income from local taxes; until the point where loss through wilful misconduct was apparent. Disqualification and surcharge would then follow.

C. IMPLICATIONS

4. Enforcement of a "sincere" budget will be particularly contentious to those authorities chosen for budget vetting. The main problem areas are:

a. identification of highly selective, justifiable "triggers" to set the process in motion. These could, perhaps, be based on past spending compared with plans or the presence of an accumulated deficit on revenue account;

b. identification of criteria by which the budget could be judged "sincere". Most medium to large authorities will produce budgets covering many thousands of individual votes. Except in the most blatant cases, an auditor will find it difficult objectively to judge the sincerity of the budget. He will probably have to rely on professional judgement. The problem will be compounded by the extremely limited timescale for budget preparation.

c. The tactics of confrontation. In cases where insincerity was identified, matters would be brought to a head quickly, either through a writ for mandamus or because the authority would be prevented from levying local taxes. For tactical reasons, this might not be desirable, as events have shown this year. It would be particularly unwise to create the opportunity for "martyrdom".

5. The vetting process would be a major development in the role of the external auditor, and perhaps not a welcome one given that it would set him against elected politicians. His job could be eased, if a duty was placed on the Treasurer to report proposed insincerity to him. But this would create difficult and uncertain relationships between Treasurers and their employers which would be resented in the vast majority of authorities. The views of the Audit Commission have not yet been canvassed.

6. It has been suggested that vetting could be carried out by a "higher" tier, rather than by the Audit Commission. For shire district councils, the higher tier would be the counties. For other authorities it would be Parliament. At present, however, there is no concept of hierarchy in local government. District councils would not accept that counties were competent to vet their budgets, particularly where political control differed. The practical problems would also be more acute than for the selective scheme.

7. Even though highly selective in operation, the requirement to prepare a "sincere" budget would be unpopular with local authorities, who would regard it as running contrary to the rest of the package. The counter-argument is that freedom for the many can only be achieved if there is a sufficiently robust framework to deal with the abuses of the few.

D. CONCLUSION

8. We recommend that appropriate measures be worked up in consultation with the Audit Commission to promote "sincere" budgets.

Annex I

INDIRECT TAXES

A OBJECTIVE:

1. If it were required to reduce the required yield of the residents' charge without increasing the proportion of local authority expenditure met by grants from central government then we would need an extra local tax (or taxes).

B SPECIFICATION:

2. We have looked at alternative sources of revenue for local authorities. We have divided these into 3 categories:

   (a) an assigned revenue, with the national yield used to set the amount of grant which would then be distributed per capita

   (b) an assigned tax, with the rate set nationally, but the proceeds left to fall locally

   (c) a locally variable tax.

The main purpose of the supplementary tax is to provide local authorities with additional revenue independent of central government. But any source should not reduce unacceptably the link between expenditure and the level of the residents' charge. The options are discussed in turn.

(a) An Assigned Revenue

3. An assigned revenue would offer at best presentational gains: in practice it would give local authorities only a limited degree of independence from central government, and there would be no link between local spending and locally raised revenue.

4. We have looked at options for an assigned revenue which could displace the standard grant and reduce the required yield of the residents'

charge. Two indirect taxes offer sufficient scope: VAT and Road Fuel Duty (the excise duty on petrol and derv). The 1985-6 England yield of Road Fuel Duty was £5.2 bn, which would allow the required yield of the residents' charge to be reduced by just under £1 bn, one third of VAT proceeds yield an equivalent amount.

5. A "tax-sharing" arrangement between federal and state government is a feature of the financial arrangements of many federal countries. There is no precedent in the U.K. If it were to work in practice it would mean local government being given, as of right, the proceeds, or part of the proceeds, of a tax raised nationally.

6. Under some but not all models of such an arrangement, central government would lose control over one lever for influencing the level of local government expenditure. It would cede its right to determine both the aggregate amount of taxpayer support for local authorities and how it was raised. Its room for manoeuvre in national tax policy would be reduced - changing the rate or the coverage of a shared tax would have implications for the yield for local as well as central government.

7. The cost to local authorities would be greater uncertainty about the quantum of grant in any one year, as compared to cash-limited block grant. This could be overcome by linking the local authority share to the yield one or two years previously.

8. Of the two options set out in paragraph 4, local authorities could be assigned the entire yield of Road Fuel Duty. Since RFD is a specific not an ad valorem duty, the yield does not automatically increase with general inflation or the cost of petrol or derv. It is for the Chancellor to decide in every Budget by how much to increase the specific duty. If RFD were to become as assigned revenue there would have to be a commitment, for example, to maintain the real value of the duty. But this would reduce the scope for using RFD as an instrument of policy, for conservation or other reasons. That could be preserved if central government were allowed to surcharge the RFD rate.

9. The alternative of a share of VAT would also pose problems. If local authorities were given a share (say one third) of VAT proceeds, government would be loth to change the rate of VAT and give local authorities a windfall gain. So arrangements would have to be made to alter the calculation of the share to enable central government to change the rate.

10. Similar problems arise with changes to the coverage and collection arrangements for VAT. These can alter the yield. Only about one half of goods and services currently bear VAT, so there is substantial scope in theory for changing the coverage. This might be tolerable if changes in yield were in hundreds of millions as opposed to billions of pounds. The local authority share would have to be recalculated in the event of a major change to the coverage of VAT.

11. The advantage of a specified share of VAT is also the disadvantage. Since VAT, unlike Road Fuel Duty, is an ad valorem tax, it increases automatically with inflation. Broadly speaking the yield of VAT should increase in line with money incomes - keeping pace with the real growth of consumer expenditure as well as prices. Road Fuel Duty, even if index-linked, is likely to be less buoyant, as increased mileage is offset by greater fuel efficiency of engines. But if central government wants to retain pressure on local authorities to reduce their spending as a share of GDP, VAT as an assigned revenue would have to be combined with either (a) declining grant in real terms as and/or (b) declining non-domestic rate poundages in real terms.

(b) An assigned tax, with locally retained proceeds

12. In many ways this proposal has similar advantages and drawbacks to the pure assigned revenue approach. The added bonus would be that the shopper in Newcastle might feel he was contributing to Newcastle's spending, not to the Exchequer. But since the tax rate would be the same in Newcastle and Esher, the gain in accountability would be minimal.

13. There are however severe drawbacks in this proposal. The first is that present collection procedures for any of the major indirect taxes are not based on local authority areas. Road Fuel duty is collected at an early point in the distribution chain where "duty points" can be concentrated. VAT is collected nationally and one return comes from large chains of stores. So the only way in which the proceeds could be allocated would be by distributing according to some proxy based on consumer expenditure survey data. But to do that properly would require data not just on where people lived, but also where they did their shopping.

14. The other major drawback is the local variability of the yield. For VAT, major shopping centres would benefit disproprotionately to the disbenefit of their hinterlands. This effect is particularly acute in the conurbations. Similar problems apply to Road Fuel Duty - the 1985-6 yield per adult of Road Fuel Duty in Tyne and Wear is forecast to be £78, in Berkshire £165. So with either option a complex equalisation process would be needed, undermining the whole point of letting the yield fall locally. This approach seems to have nothing to commend it.

(c) <u>A locally variable tax</u>

15. We have examined three options:

- (i) a Local Sales Tax
- (ii) locally variable Road Fuel Duty
- (iii) locally variable Vehicle Excise Duty

16. A <u>local sales tax</u> would be a single stage tax, levied at the retail stage. It would not be levied, like VAT, at each point where value was added. It could, but need not necessarily, cover the same range of goods as VAT. In 1983 Customs and Excise estimated that collecting a local sales tax would require an additional 2,000 - 3,000 staff.

17. There are other objections to a local sales tax. A Local Sales Tax would blur accountability - it is hard to perceive; it blurs the link between voting for, paying for and using services, because of the substantial degree of cross-border shopping; because of the problem of regional shopping centres (paragraph 14) there would have to be an

equalising grant. Moreover locally variable LST would give local authorities a very bouyant source of income: it would undermine the effectiveness of the residents' charge in restraining local expenditure.

18. Locally variable Road Fuel Duty has less intrinsic bouyancy. But its yield varies so much between authorities even when levied at a common rate, that allowing local authorities to have a locally variable RFD would destroy any link between the level of residents' charge and the level of services.

19. There is another possibility, which is locally variable Vehicle Exise Duty. This could be administered through the DVLC, but with the rate of tax being determined by the keeper of the car's address. There would be some cost in terms of the deterioration of the DVLC records as an accurate register of addresses insofar as there was an incentive to register at a false address.

20. Locally variable VED on cars and light vans could yield a useful <u>supplement</u> to the residents' charge. It would not replace the standard grant. The 1985-6 England yield is forecast at about £1.3 bn. The disadvantages of locally variable VED is that it would place yet a further burden on inner cities where car ownership is much lower than average. For the same level of services these authorities would have to levy a higher residents' charge and higher Vehicle Excise Duty than an authority with high car ownership. <u>Within</u> an authority, a locally variable VED would tend to reduce the regressiveness of the switch from domestic rates to a residents' charge, since higher income households tend to have more cars.

<u>CONCLUSIONS</u>

21. The only runners which at present seem worth considering are:

(i) give local authorities a share of VAT or all of Road Fuel Duty as an assigned revenue to replace the standard grant and reduce the required yield of the residents' charge by about £1 bn; the yield would be distributed per capita

(ii) allow local authorities to use VED as a supplement to the residents' charge; the rate could be varied locally, but the tax would be collected by the DVLC.

22. Any reduction in the residents' charge would have to be made up by an increase in other taxes. Replacement of the standard grant would not need to be.

23. This paper has not looked at minor revenue-raisers which could help authorities with particular needs or demands on their services not picked up by the new needs assessment. One option is a tourist tax. This would need to be looked at in conjunction with proposals for taxing residents in hotels etc (Annex C). This could provide a useful source of income in a few city and resort authorities. We will consider further.

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