

LOCAL GOVERNMENT FINANCE REFORM

The DoE's 'Specification Report' explores the effects of the reforms that you discussed at Chequers.

Apart from the nationalisation of the non-domestic rate, the DoE package has always looked promising. The advantages were discussed at Chequers: Councils would be more accountable to their local electorate; they would not be able to overtax businesses; overspending would not be made easier by redistributive grants; and we could abandon the unpopular controls of the present system.

But it was clear that a proper judgment could not be made until the detailed numbers were available. In general, these are good news: the DoE's new studies show that, as we expected, richer areas and voters would benefit, as would prudent councils with high resources.

However, the study shows that the package, in its present form, would have a number of unpleasant effects: - see flag B1

1. 7.5 million households (44%) would lose out (1 million would lose more than £250 pa).
2. Some parts of London - including some which are politically sensitive - would be very badly hit: the local tax paid by each adult would in some cases almost double.
3. The inhabitants of some Northern industrial areas would also suffer large personal tax rises.
4. Some inhabitants of low-spending Shire districts would face personal local tax rises of about 20%.

5. People with gross incomes between £5,000 pa and £12,000 pa would be badly affected, if they lived in Inner London or the Northern industrial areas. This would accentuate the 'poverty trap'.
6. Business rate-payers would lose, both in thriving suburban areas and in rural Shire districts. Their (non-domestic) rates would rise by between 10 and 16%.

The DoE recognise all of these problems; but they have not yet developed means of dealing with them. Unless some of them can be sorted out this reform is unattractive.

More work will be needed on:

- The new, simplified, grant system. It will still require an assessment of need. How can this be done, to avoid repetition of the incomprehensible complexities of the present Grant Related Expenditure Assessment?
- The effect of the proposal on total LA spending.

Subsidiary Issues

- Capital Spending. (Annex E). The third option - control over all net external borrowing - is the best. This will ensure that Local Authority borrowing stays within planned limits, whilst removing the hated control on the spending of money raised from sales. But more work will need to be done on the method of setting limits and on the transitional arrangements.
- Fees and charges. (Annex F). We doubt whether DoE pessimism about scope for more charges is justified. The first step will be to find out how an authority

like Colchester manages to raise 29% of its rate fund expenditure through charges, and then to devise an effective system of bringing other councils to do likewise. More work will be needed on this, too.

- Administration of a "Residents' Charge". Annex C of the DoE report outlines some of the arrangements that would be required to collect a "Residents' Charge". DoE rightly conclude that a new register, separate from the electoral role, will be needed - to avoid the accusation that it is a "tax on votes". But more work needs to be done on methods of enforcement, particularly for people moving from one locality into another. The suggestion of a "graduated" charge should be resisted: this would be an administrative nightmare, without even having the advantages of a properly constructed local income tax, and it would make the tax more buoyant for high spenders.

- Annual elections. Annual elections deter Councils from engaging in massive pre-election manoeuvres. But:
 - i. even fewer people will turn up to vote;
 - ii. many local councils will regard this as a central imposition on their age-old traditions;
 - iii. it is difficult to defend Westminster elections;
 - iv. to implement the new system you either have to extend Councillors' terms (suspending elections) or sack Councillors early.

We still think the idea should be dropped.

- Education Spending. Keith Joseph, in his minute, recommends that the DES should be able to withdraw

money from Government grant, and use it to influence LEA behaviour in accordance with the Government's priorities. For some purposes, this could be very useful: as, for example, in the teachers' pay dispute. But - if it were made a general power - it would give a future left-wing government an enormously enhanced capacity for making trouble, and it would enrage our local government supporters. The Chancellor's proposals of complete centralisation would be even more unpopular with the shires, who are largely education authorities. We therefore suggest that such moves should not be included in the package (though a much modified form of the proposal might be introduced separately).

Political Problems

There is likely to be opposition to the proposals within E(LF). Some of this may be defused by a promise to conduct further work in order to minimise the unpleasant effects of the scheme. But there are problems that will not go away:

- a. Some Ministers, such as Leon Brittan (and, we understand, Michael Heseltine) believe that there is in fact no problem about local authority finance. They cite the slow-down in local authority spending and they argue that any change will prove unpopular. They want the Government to abandon the Reviews.

Although DoE exaggerate some of the problems, the present system is under great stress. The Government is widely criticised for its local authority policies. The Far Left is having a field day. Our Councils feel hard done by.

- b. The Chancellor agrees that the present system is a mess, and accepts that a self-regulating system of

local finance, (in which local authorities were genuinely accountable to their electorate), would be preferable. But he believes that a change from domestic rates to a "residents' charge" would be massively unpopular. He therefore advocates that the DoE package should be amended by reinstating domestic rates, with no rebates above 80% to ensure that every household pays something for local services.

This scheme is certainly a runner. It would have many of the advantages of the DoE proposals, with less political risk. Norman Fowler, Keith Joseph and Norman Tebbit may support variations on this theme. But there would have to be a new system of revaluing the rate base and of automatically protecting people from sudden rises.

Besides these internal doubts, there are a large number of people outside government who have already commented adversely on the clumsy versions of the proposals which have been leaked or openly mooted by Ministers. In particular, two items are likely to prove unpopular with the backbenchers and amongst our local authority supporters:

1. The nationalisation of the non-domestic rate will be regarded as a centralising measure, and will be opposed. Why not instead place a simple form of rate-capping on non-domestic rates? E.g. no council to increase its non-domestic rates by more than, say, 2% above inflation. This would prevent any of the sudden shifts in the non-domestic Rate Bill that the DoE proposals would cause and would still allow some difference between high and low spending councils.
2. The "poll tax" will be attacked as both a "tax on votes" and for its regressive nature. The leaks have made sensible change much more difficult to achieve,

with Poll Tax regarded as a tax on the vote and with CIPFA's unhelpful figures publicised on Weekend World. A modestly priced local Residents charge now has to overcome these stigma.

Next Steps

It will not be possible to reach agreement on any firm proposal at this meeting of E(LF). Nor would it be wise to do so.

However, it is important that the momentum should be kept up in Whitehall, and that there should be a reasonably open public discussion, in which the Government can explain its concerns and prepare the ground for radical changes without committing itself to any particular proposal.

We therefore recommend that:

1. DoE should be asked to do further work on their present package so as to:
 - a. devise methods of minimising unpleasant effects;
 - b. explain in detail how the new grant system would work and predict public expenditure consequences;
 - c. show as an alternative to the nationalisation of the non-domestic rate a simple form of non-domestic rate-capping.
2. The DoE should also be asked to work up a second version of their proposals, in which domestic rates are retained, and with a system for crawling revaluation.

3. While this work is going on, DoE could revise their "introductory report" (the glossy green brochure) so that it exposes the present problems, but ~~is~~ ^{without canvassing} ~~entirely neutral~~ ^{at this stage,} about any solutions, and invites comments from all interested parties. This could be issued within two or three weeks, inaugurating a public discussion, in which Ministers might take part through a series of public seminars and private discussions.
4. DoE should be asked to report back to E(LF) by September at the latest, with:
 - a. a fully worked out version of their present proposals, revised as necessary;
 - b. a similarly detailed study of the Chancellor's package, retaining the domestic rate (but without switching educational expenditure to the centre);
 - c. a detailed analysis of the comments made during the public discussion;
 - d. a firm proposal to help our low spending Councils subject to capital controls.

Armed with this material, Ministers would be in a good position to judge whether either the amended DoE package, or the Chancellor's variants were workable and saleable. Further work could then be undertaken to produce a White Paper by the end of the year if the public debate shows an appetite for change.

JR.

JOHN REDWOOD

OL. Letwin.

OLIVER LETWIN