E(LF)(O)(85) 2nd Meeting COPY NO 26

CABINET

STEERING COMMITTEE ON LOCAL GOVERNMENT FINANCE STUDIES

MINUTES of a Meeting held in Conference Room A, Cabinet Office on WEDNESDAY 18 SEPTEMBER 1985 at 10.00 am

PRESENT

Mr P F Owen
Department of the Environment
(In the Chair)

Mr E Wright
Department of Trade and Industry

Ms J E Reisz
Home Office

Mr N W Stuart
Department of Education and Science

Mr M G Jeremiah
Welsh Office

Mr R Walmsley
Department of Health and Social Security

Mr B Lyttle
Northern Ireland Office

Mr I Yass
Department of Transport

Mr R A J Mayer
Department of the Environment

Mr B Houghton
Inland Revenue

Mr A J Langdon
Cabinet Office

THE FOLLOWING WERE ALSO PRESENT

Mr A C S Allan
Treasury

Mr J Halliday
Home Office

Mr B Philp
Scottish Office

Mr J Smith
Department of the Environment

Mr P D Ward
Department of the Environment

SECRETARIAT

Mr J E Roberts
Ms J Rutter

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1. SECOND SPECIFICATION REPORT

The Committee considered a Note by the Secretaries covering the 'Second Specification Report' prepared by the Department of the Environment (DOE) setting out the results of further work on the Local Government Finance studies (E(LF)(O)(85) 4).

THE CHAIRMAN said that at the meeting of the Ministerial Sub-Committee on Local Government Finance (E(LF)) in May DOE Ministers had outlined proposals for a new system of local Government finance. There were three elements; a national non-domestic rate with a yield pooled and then paid out at a flat rate per adult to all authorities; a radically reformed grant system, comprising a fixed lump sum needs grant designed to compensate local authorities for differences in their assessed expenditure needs, and a standard grant paid out at a flat rate per adult; and the replacement of domestic rates by a residents' charge. While E(LF) had welcomed many of those proposals, there had been three main points of concern: the residents' charge might be too regressive; some elements of the package might appear too centralist; and doubts about the effectiveness of the package in controlling local Government expenditure.

The Second Specification Report set out the results of further work. The proposals on non-domestic rates were essentially unchanged, but at the suggestion of the Confederation of British Industry (CBI) it was now proposed that the annual increase in the nationally determined rate poundage should be linked by statute to the autumn forecast of the Gross Domestic Product deflater, and that local authorities should be allowed to levy a discretionary local rate at up to 5 per cent of the national rate and to keep the proceeds in order to maintain a genuine link between commerce and local Government. It was proposed that the change to a national non-domestic rate should be combined with a revaluation, and phased in over three to five years. The proposals on grant distribution were unchanged in detail. As tables 3 and 4 of the report demonstrated, the new arrangement would maintain considerable pressure on local authorities to moderate their expenditure. But it was now proposed that in order to make the system of grant determination more automatic a hypothecated share of the national yield of Value Added Tax (VAT) should be assigned to local Government: this had the advantages of reducing central Government involvement (and hence to some extent counteracted the increased centralisation implicit in the proposal for non-domestic rates) and of making clearer to tax payers the total burden represented by local Government expenditure. On the local domestic tax, Ministers now proposed that this should be raised 70 per cent from a residents' charge and 30 per cent property tax. Although a full analysis had not been done, the provisional suggestion was that floorspace should be used as the basis of valuation. Under the new grant arrangements there would be no resource equalisation, so that differences in property values between local authorities would not affect local tax bills. Ministers had adopted this combined local charge because it would be more moderate in the size of changes introduced, and looked more gradualist. Tables 8 and 10 and Annex VII of the Specification Report set out the impact of these proposals by local authority and by household type. These calculations were based on a number of assumptions about needs assessment, but could be regarded as reasonably robust. They showed that there was a heavy concentration of small losses and gains (of up to £2 per week), and that in total there were more gainers than losers. The North Yorkshire and Humberside, together with Central London, fared badly, while the home counties and South East performed well. It seemed to Environment Ministers that the scale of changes were more manageable than those which would have resulted from the original proposals, and although effective transition arrangements would be required, the package represented a realistic option.

The following are the main points made in discussion -

a. Allowing local authorities to levy an additional 5 per cent domestic rate would add an extra complexity to the system, and so should only be done if there was a good case. The level of 5 per cent had been chosen for pragmatic reasons. A larger sum would forge a stronger link between commerce and the local authority, but it would allow authorities with high non-domestic resources to generate an unduly large extra revenue thus undermining the accountability aspects of the package as a whole.

b. Under the existing Rate Support Grant System, central Government established the Aggregate Exchequer Grant, and from this specific grants were subtracted before the quantum of block grant available to equalise both needs and resources was determined. Under the new proposals, the needs grant would be calculated so as to put authorities facing different levels of need on a common footing. The standard grant element would be calculated by reference to the yield of VAT, and specific grants would be determined as now. The total Exchequer resources available for local Government would therefore be established by adding the three independent components.

c. The quantum of the needs grant would be determined by allocating the aggregate public expenditure total for local Government to authorities according to their GRE assessments. Each authority would then receive a grant to compensate for the cost of providing a standard level of service above the cost for the authority with the lowest needs assessment per head. In operating this system Ministers would still need to reach a decision about the balance of the needs element of the grant against the likely local tax rate.

d. A number of European countries had devised workable arrangements for hypothecating a VAT yield for local authorities. Often the amount available was determined by reference to the VAT yield in the previous year, in order to avoid unnecessary uncertainty in local authority budgeting. It was recognised that the yield of VAT was buoyant, and that this would allow local authorities to increase their spending broadly in line with consumer spending. Although the percentage of VAT yield assigned to local Government would be reviewable by Parliament, central Government would have much reduced control over the standard element of the grant.

e. Environment Ministers recommended floorpace as the basis for a new property tax because it was easily understood, transparent, and involve no revaluations. There was a degree of correlation between floorspace occupied and ability to pay, although it was recognised that capital values were a better proxy in this regard. It was also recognised that there would be considerable difficulties defining residents precisely.

f. Annex VII showed the effects of the changes by household according to regions, including Greater London as a whole. It was hoped that it would be possible to do further analysis by clusters of local authorities, but it was not possible with the data available to estimate the effects on different types of household for individual authorities.

THE CHAIRMAN, summing up the discussion, said that subject to the outcome of the Ministerial discussion, it was hoped to publish a Green Paper towards the turn of the year. This would be open to consultation on all points. During the consultation period there would be a great deal of effort devoted to explaining the proposals.

The Committee -

Took note, with approval, of the Chairman's summing up of their discussion.

2. MODIFIED PROPERTY TAX

The Committee considered a note by the Secretaries covering a report by the Inland Revenue on a possible Modified Property Tax (E(LF)(O)(85) 5).

MR HOUGHTON, INLAND REVENUE, said that the objective in developing proposals for a modified property tax had been to maintain many of the existing advantages of rates while meeting some of the objections. The key advantage of retaining a property tax was the reduced amount of disruption in comparison with more novel approaches. It was recognised that rental values no longer provided an adequate base for taxation, and it was therefore suggested that capital values should be used. The report examined the possibilities of banding values and of unitisation, which might provide flexibility in adjusting the burden of taxation. In order to avoid the major disadvantages inherent in periodic revaluation it was suggested that values should be increased annually according to an index, with periodic adjustments. Some form of indexation within broad bands might simplify the process. Any proposal to increase the property tax on homes with high occupancy faced the same administrative problems as the residents' charge, and if that proved a practicable tax there would be no difficulty about incorporating an occupancy element in the property tax. As an alternative the report considered occupancy relief, under which people over 60 living alone could claim a rebate. The details had not been worked out, but such a scheme would be likely to be easier to operate and be largely self-policing.

In discussion the following points were made -

a. Under the Department of the Environment reform package the local domestic tax would have to bear the whole burden of any increase in spending. It was important that the tax should be capable of bearing this role.

b. If, as had been recommended, resource equalisation were abandoned, the basis of valuation would affect only the distribution of tax demands within a local authority area. The variation in capital values across the country would therefore have no effect on individual rate bills.

c. The likely objections to a property tax on the line suggested were primarily political rather than technical. It would represent a continuation of rates; because of the link with capital values it was akin to a wealth tax; it did not widen the tax base to involve more local electors. Furthermore, there would be the turbulence associated with a revaluation, although it was recognised that any reform of local government finance would cause some turbulence.

d. Although there were many technical attractions in the proposal, it was more complex than a simple residents' charge.

THE CHAIRMAN, summing up the discussion, said that the Committee was grateful to the Inland Revenue for circulating their report.

The Committee -

Took note, with approval, of the Chairman's summing up of their discussio

3. REACTIONS TO THE PROPOSED REFORM PACKAGE

The Committee discussed a number of points which were thought likely to be raised at the meeting of the Ministerial sub-committee on Local Government Finance.

The following were the main points made -

a. The Department of the Environment (DOE) package might be seen as abdicating the Government's responsibility to control local authority expenditure. The marginal pressure on spending under the new system would be less than had applied to the most high-standing authorities under the target regime. It seemed likely that some top-down pressure would be required, provided through the progressive withdrawal of Exchequer grant and ultimately the capping of local taxes. The DOE proposals on Government grants could also be criticised as introducing too much automaticity and buoyancy into local government spending. While it was true that there had been conflicts between central and local government, the underlying cause was local government's propensity to excessive expenditure, and it would be wrong to avoid conflict by conceeding local government's right to spend without control.

b. In the presentation of the numbers of gainers and losers under the DOE proposals, it was potentially misleading to take allowance for the effect of rate capping on reducing the level of the residents' charge which would have to apply in most high spending areas. Even if the number of gainers and losers were roughly equal, the experience of the recent Scottish revaluation suggested that a great deal of political difficulty might be incurred.

c. The retention of rates would produce a less regressive regime than a residents' charge, but to the disadvantage of the very poor many of whom lived alone.

d. Following the experience of the Scottish non-domestic revaluation, there was some pressure to reflect turnover in assessing rental values. There was a great deal of antipathy in Scotland to any form of domestic property tax.

e. In Wales, the existing Rate Support Grant system had been reasonably successful in achieving the Government's public expenditure targets. While much of the DOE package was acceptable, it was important that changes should only be made if they were an improvement.

f. The DOE proposals for the grant distribution mechanism would tend to obscure the normative elements in the present arrangements. There was therefore a case for hypothecating both the standard grant and the need grant to particular services in order to improve the degree to which central government could influence local authorities towards the achievement of national policy objectives.

g. The proposals could increase by three-quarters of a million the number of people eligible for Housing Benefit, and the impact on the Social Security programme would need to be carefully considered.

THE CHAIRMAN, summing up the discussion, said that, depending on the outcome of the Ministerial discussion, it seemed appropriate for the Committee to continue, but to meet as and when necessary. The Working Group on Distribution Effects would continue work at a technical level and would provide a degree of co-ordination. In addition there was to be a review of specific grants, possibly under Treasury chairmanship. Other ad hoc meetings would be held with interested Departments as proposals for specific aspects of the package were developed.

The Committee -

Took note, with approval, of the Chairman's summing up of their discussion.

Cabinet Office

19 September 1985