

1. MR POTTER ^{BHP} 15/4
2. CHIEF SECRETARY

FROM: R FELLGETT

Date: 15 April 1988

cc: PS/Chancellor
PS/Financial Secretary
PS/Paymaster General
Sir Peter Middleton
Mr Anson
Mr Phillips
Mr Scholar
Mr Hawtin
Mr Culpin
Mr R I G Allen
Mr Pickford
Mr C Riley
Mr C Ford
Mr Tyrie
Mr Call

THE COMMUNITY CHARGE AND THE BUDGET

Mr Howard's letter dated 28 March to the Financial Secretary concerns the argument that the Community Charge is not unfair, because high income households will continue to contribute more to local authority revenue than low income households. This is partly a consequence of rebates, and partly because Exchequer grant (financed by progressive central taxation) forms such an important part of local authority revenue.

2. This submission covers a draft reponse to Mr Howard. It also offers advice on the request, in Paul Gray's letter of 13 April to Mr Howard's office, for a note on the basis of DOE's estimate of the relative contribution of rich and poor households.

3. In view of this correspondence and the No.10 remit, we have looked again at the available estimates. Our view is that it is not unreasonable to argue that the top 10% of households by income would, on 1985 grant and tax arrangements, if the Community Charge system had been in place, pay around 15 times as much as the bottom 10%. This is the figure which Mr Howard

quoted to the Prime Minister, and which she used in the House yesterday. It is also the one that we thought we had agreed with DOE officials last summer. (The actual DOE calculation then produced a figure of 16, which we thought over-precise.)

4. In response to the No.10 remit, DOE are today preparing a description of the derivation of this ratio, which they will clear with us. That will defend the ratio of "about 15".

5. There are considerable uncertainties about any such estimate, which must be subject to a wide margin of error. In particular, this figure:

(i) is based on sample data about 1985 income and tax payments; changes since then in the distribution of incomes and taxes, the proportion of local authority revenue formed by grant, and the recent announcement about rebates, will all have changed the number (although not all in the same direction);

(ii) ranks households by gross income (which includes benefit payments) rather than original income (which does not). Using original income would give a somewhat lower figure of about 13;

(iii) covers only local authority rate fund revenue in England. Including other revenue, for example borrowing or housing revenue, or including Scotland or Wales would be liable to alter the figure;

(iv) adopts a fairly naive treatment of company taxes, and in particular the extent to which these are attributed ultimately to persons.

6. In the light of these points we think the DOE estimate for 1985 could be if anything a little on the high side. A slightly lower figure of 13 might be more appropriate, but a figure of about 15 remains defensible.

7. It would be possible to do some more work to refine the DOE estimate. We could, for example, attempt to project the estimates forward from 1985 to 1988 using the information on income distribution underlying the Budget costings. We could also look further into some of the issues listed above. But the number would still probably be subject to a good deal of uncertainty, and there may be little to gain from producing a more refined estimate. But if you wish we could pursue this further.

8. As for Mr Howard's letter, this is the latest in a number of difficulties with DOE about estimates of this sort. In this case, Mr Howard told Sir George Young in the House that the effect of the recent Budget tax changes would be to reduce the ratio from 16 to 15. Quite apart from the unnecessary precision in these figures, it seems extraordinary that Mr Howard did not realise that there might be some Treasury sensitivity over such an estimate of the effect of the Budget on the richest and poorest households. He was answering Questions before the start of the second day's Budget debate. DOE officials had assured us that morning that no such figures would be quoted publicly. Fortunately, the figuring does not seem to have picked up in the Budget context. Any assessment of the effect of the Budget should ideally allow for behaviour responses, which would tend to offset at least partially any reduction due to the cuts in basic and higher rates. We would certainly not wish to see any estimate given in public at this stage, beyond saying that any effect is likely to be small.

9. It is primarily for Mr Howard to decide whether there was anything he said to Sir George Young that calls for clarification in a letter. If, however, he feels it necessary to write, the draft attached to his letter to the Financial Secretary seems acceptable apart from the reference in the third paragraph to the fact that "the ratio is unlikely to fall below about 15:1 as a result of the recent Budget". Our view is that this is incorrect. Instead, he might say simply that the ratio is "unlikely to change greatly".

10. The draft letter attached also refers to the overall ratio, which DOE now seem to accept should be referred to as "about 15", to avoid undue precision.

11. This advice has been agreed with FP and ETS.

Robin Fellgett

R FELLGETT

DRAFT LETTER FOR THE CHIEF SECRETARY'S SIGNATURE

To: Minister for Local Government

THE COMMUNITY CHARGE AND THE BUDGET

Thank you for your letter dated 28 March to Norman Lamont. I have also seen the No.10 remit of 13 April, which our departments are discussing.

① 2. It is unfortunate that you were not aware of the extent of Treasury sensitivity about estimates of this sort before you gave your answer to George Young before the second day of the Budget debate. The Budget tax changes provoked a good deal of comment about their relative effect on the richest and poorest people; and I understand that my officials had been assured by yours that no estimates would be made of the effect of Budget tax changes unless they had been carefully checked and cleared first with the Treasury. Fortunately, however, the figures were not picked up in the Budget debate.

3. It is of course for you to judge whether there was anything you said to George Young which calls for further clarification in a letter. If you do write, I have no objection to the draft attached to your letter subject to changing "fall below about

15:1" to "change greatly" in the third paragraph. On recent tax and grant arrangements, if the Community Charge system had been in operation the ratio would quite likely have been close to 15, but it could have been less.

4. There are inevitably considerable uncertainties about such estimates. Other bases for the calculation could well produce different numbers, and of course the precise ratio is likely to change over time. As my officials discussed with yours some time ago, and have clarified again following the No.10 remit, it therefore seems best to talk about a broad ratio of "about 15" in any public discussion.

5. I see from the draft that you have a Written PQ on this subject, and no doubt further enquiries may be made of you. I should be grateful if your officials could clear any such answers, and any form of words used in other contexts, with mine if they concern in any way the Budget or national taxation generally.

[J.M]

mp

*Ch/ Robert has had a go at sorting this out
(a) and (b) are behind*

FROM: ROBERT CULPIN
DATE: 15 April 1988

CHANCELLOR

*-but (b) was not cleared with us, and so
I have agreed with Paul Gray that he will not
show it to PM this wk-end [none of this will
stop her or DoE using this statistic, and if we
are going to produce a sorting out
note, it might as well be one agreed
with us.] Shall I minute*

WHO PAYS FOR LOCAL GOVERNMENT

I think I should give you a note to go with

- (a) *PS/CST or Paul Gray along lines of RC's para 11? Or leave officials to pursue agreed note for No 10?*
a submission from Robin Fellgett to the Chief Secretary on the Community Charge and the Budget; and
- (b) a letter from Michael Howard's office to Paul Gray on much the same subject. *mpw*

I have not seen either as I dictate this; but both should reach your weekend box. *15/4*

Background

2. As you know, the DOE want to make the point that, even after the Community Charge is introduced, the rich will still pay more for local government than the poor. That is plainly true: much of local government will be financed from general taxation, and the rich pay more tax than the poor.

3. They have chosen to illustrate this by saying that the top 10 per cent of households will pay x per cent more than the bottom 10 per cent. I have been trying to get a grip on x.

*1 suggest - PS
hnt (Paul Gray) from
my office) make (with Gray)
explanations) pts (i) & (ii)
or Para 11, but note
bottom (iii).*

4. They first put it at 20 in a Press Notice. They subsequently agreed with LG to stick with something vaguer - "about 15". But they keep reverting to a spurious precision. Mr Howard recently said in the Commons that x was 16 before the Budget, but will be 15 after it.

Latest statements

5. The Prime Minister said in the House on Thursday that, under the Community Charge, "10 per cent of households with the highest income will pay 15 times as much towards the cost of local services as the 10 per cent of households with the lowest incomes" (Col 341).

6. I understand Mr Ridley used much the same formula in a letter yesterday to Mr Mates.

Facts

7. The facts are these.

- (a) We could probably defend a figure of broadly 15, on some definitions, essentially on 1985 data, and rounding to the nearest 5.
- (b) We are pretty confident that the Budget is unlikely to make a huge difference to the statistic, whatever it is. It is unlikely to alter it by more than, say, 1.

However:

- (c) Our central estimate would probably be a bit below 15.
- (d) It is quite possible that, after the Budget, "broadly 15" might have to encompass (say) 12. Some might call that broadly 10.

(e) The statistic has, in the past, changed from year to year. It is certainly not a constant.

(f) No one has attempted to extrapolate the data beyond 1985, or just possibly (in one DOE case) 1986.

8. So even if the DOE's arithmetic is right, all it really tells us is that, if the Community Charge had been in force in 1985, the top 10 per cent would then have paid about 15 times more for local government than the bottom 10 per cent. Obviously that is not the same as saying that the top 10 per cent will pay (without qualification) 15 times more than the bottom 10 per cent when the Community Charge comes in, which is what the Prime Minister claimed in the House.

9. The plain fact is that we do not know what the true statistic is now, still less what it will be when the Budget changes come through, still less when the Community Charge is introduced.

What is to be done?

10. Does this matter? It is manifestly irritating: the statistic turns largely on who pays the taxes, which is for us to say, not the DOE. And the last thing we want is anything which could be construed to constrain policy on the distribution of the tax burden at the end of the decade. But I doubt if this is worth a huge row.

- The basic point that the rich pay more is clearly right and needs to be made.
- About 15 times more is probably not far out, as a broad order of magnitude.
- So long as some reasonable justification can be

produced, I doubt if anyone is going to make a big deal out of whether the number is really 13.6 or 14.2 or whatever.

- My best guess is that, rounded to the nearest 5, the statistic is unlikely to drop below about 10 - though I certainly don't know that.

11. However, I think you should send out three very firm instructions, to reinforce the message in the Fellgett submission. These might be addressed to the Chief Secretary's office, since the submission will be addressed to him; or they might be worth a letter to Paul Gray, depending on what the letter from Mr Howard's office says. (I can't judge that until I see it. It is supposed to be cleared with us, but has not arrived by early evening.) The main points are:

- (i) It is essential that people stick to a broad order of magnitude - about/around/roughly/ of the order of 15 - and do not pretend to a spurious accuracy.
- (ii) No one should say more about the Budget than, at the most, that it is unlikely to make a substantial difference to this very broad order of magnitude.
- (iii) It would be much better to say that, if the Community Charge had been in force in the recent past, the rich would have paid about x times more than the poor than to assert (without evidence) that they will pay that when the Community Charge is introduced.

not cleared,
not shown
to PM

Howard letter
unsatisfactory
on this pt
(see x on its
p3)

ROBERT CULPIN