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SECRET

Prep

MINUTES OF A MEETING HELD IN CHANCELLOR'S ROOM HM TREASURY AT 12 O'CLOCK ON WEDNESDAY, 29 JUNE

Those present

Chancellor
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Peretz
Mr Sedgwick
Mr Potter

Miss J Wheldon - T.Sol

THE COMMUNITY CHARGE, THE RPI AND INDEX-LINKED GILTS

Sir P Middleton said that the letter from the Bank had revealed that, in the Bank's view, neither option 2 (excluding the community charges but avoiding a step change in the RPI) nor option 3 (including the community charge) would constitute a fundamental change in the RPI which would be materially detrimental to the interests of holders of indexed gilts.

2. In discussion, the following points were made:

(i) it might be possible for someone to devise legal challenges to either Option 2 or Option 3. Under option 2, someone could seek to argue that having not including the community charge in the RPI we had removed a buoyant element, to the detriment of stockholders; but it would be difficult for anyone to sustain this against the Bank's view, provided that view was properly reached on the basis of full information. Conversely under option 3, if the Government proved successful in restraining the growth of local authority spending and the community charge, someone might seek to argue that the Bank should have known that the Government's decision to include the community charge would have been detrimental to them.

(ii) It was easy to see the case for dropping rates from the RPI: they would not exist at all after 1990; but it was less easy to see any valid justification for including the community charge, which was clearly neither an indirect tax nor a housing cost. So there might be additional vulnerability on this score in choosing option 3.

(iii) DOE would be likely to argue that the community charge was not a tax but a charge for local services, and so should be included. Some DOE officials had also argued that the community charge would be buoyant, and so should be included in the RPI to protect those dependent on social security. But this line was completely at odds with the stated purpose of introducing the community charge, which was to make local authorities more accountable to their electorates and hence reduce the growth of spending.

(iv) It was unlikely that the RPIAC would make a unanimous recommendation in favour of either option 2 or option 3, whichever one the Government recommended.

2. Summing up this part of the discussion, the Chancellor said it was agreed that, even though there were some risks with both option 2 and option 3, these risks seemed acceptably low. In these circumstances, the fact that the community charge was clearly a direct tax, and so should not be included in the RPI, pointed in favour of choosing option 2.

3. There was then a discussion of the further procedures which should be followed. The following steps were agreed:

(i) We should return to the Law Officers, show them the Bank's letter and explain the changed position. We should ask for new advice, in particular on whether we were following all the proper procedures in reaching our decisions. We should also seek a written view from the Law Officers confirming that, in these new circumstances, it was acceptable to pursue option 2.

(ii) we should carry out a trawl of work done in other Departments - principally DOE - on the effect of the switch from rates to the community charge on local government spending and taxation. But we should ask for analytical work, rather than just opinions.

(iii) we should reply to the Bank and show them the analysis by the Treasury forecasters; this showed that there could be no certainty one way or the other on the buoyancy of the community charge. We should also send the result of the trawl of work done in other Departments.

(iv) Assuming that the Law Officers and the Bank confirmed that option 2 was acceptable, the Chancellor should minute the Prime Minister recording the Bank of England's and the Law Officers' views: there would be no need to copy this minute widely.

4. <u>Miss Wheldon</u> noted that there would be some advantages in also sending the Bank an analysis showing how the RPI might increase with a notional allowance for rates in it. But in discussion it was noted that it was not at all clear how this should be done or what it would signify. It would instead be better to tell the Bank that we had considered very carefully the option of doing this, but had rejected: the RPI with a notional rates component would be variable in just the same way as the projections set out by the Treasury forecasters and would depend critically on decisions yet to be taken by local authorities and the Government about spending and grant.

1 July 1988

ACSA

A C S ALLAN

<u>Distribution</u>

Those present

PS/Chief Secretary