CONFIDENTIAL

FROM: A J C EDWARDS
DATE: 23 DECEMBER 1988

CHIEF SECRETARY

cc Chancellor
Sir P Middleton
Mr Anson
Mr Monck
Mr Phillips
Mrs Lomax
Miss Peirson
Mr Potter
Mr McIntyre
Mr Fellgett
Mr G C White
Mrs Chaplin
Mr Call
Mr Tyrie

Ch
I can't see any attractions in the Treasury taking the lead in running any new options on this.
AA

[passed to PS/CST]
AA 5/1

COMMUNITY CHARGE:
TRANSITIONAL ARRANGEMENTS

The so-called "safety-net" phasing arrangements will crucially affect the impact of the Community Charge in its first few years. These arrangements will also affect the pressures on the Government to provide extra RSG: if (perish the thought) we had to provide extra grant to cover the total transfer from London and the North to the rest of the country, the amount involved would be of the order of £1 billion. Although a certain amount has been said publicly about how the safety-net will operate, the legislation leaves Ministers with a great deal of latitude.

2. Firm decisions on the safety-net will be needed during the RSG discussions in the summer or early autumn. Treasury Ministers will wish, however, to be well prepared for these discussions. We have therefore been giving some thought to what the problems are likely to be and what helpful options might usefully be examined between now and the summer. Mr Fellgett's minute attached sets out our preliminary thoughts.

3. The key point, as you will recall, is that, with the demise of dual running, the phasing arrangements as now conceived will directly affect local authorities rather than individuals. The consequences for individual charge-payers, though substantial in many cases, will be a by-product.

4. As Mr Fellgett's minute explains, there would be various possibilities for amending the safety-net arrangements. My own instinct is that the notion of minimising any change in the distribution of revenues between local authorities in the first, critical year of the Community Charge remains a sound one, though there may as Mr Fellgett points out be disappointment, particularly in the South of England, that gains will not begin to come through, at authority level, until 1991-92. On average, households within any given authority which continues to spend at the same level in real terms will pay the same in 1990-91 as they would have done under the existing domestic rating system.

or at least not one the Treasury has good interest in disturbing

5. The devil lurks, of course, in the words "on average". At the individual level, many households will face large increases in their bills (up to about £500 per head). Others will receive large reductions. The problems are likely to be especially acute, as so often, in London, where significant numbers of people now paying little or nothing will in 1990-91 face bills of more like £350 per head (rising to £550 after the transition). More generally, the main losers will be people living in low-value accommodation, especially in high spending areas.

A bit misleading

6. It was doubtless with this in mind that No.10 Policy Unit advisers (now departed) persuaded the Prime Minister to raise the possibility of amending the safety-net arrangements so as to place a limit, say £350, on the Community Charge which anyone should be expected to pay in the first year. For the reasons explained in Mr Fellgett's minute, we do not think this is a good idea. Neither, we think, does Mr Ridley. You might like to send a short minute supporting Mr Ridley's tactful note to No.10 on this subject. A draft is attached to Mr Fellgett's minute.

H.B! HB

The fundamental issue, as it seems to me, is whether it is a viable strategy to do nothing directly to protect the position of individuals. We think there might be an option to introduce a safety-net at the level of the person or household as well as the local authority, which would limit the annual increases in the rates/Community Charge bills of individual households on a self-financing basis within an authority. The idea raises all sorts of difficulties, which Mr Fellgett's minute briefly mentions. From a narrow Treasury point of view, however, a personal safety-net could significantly reduce the pressures to provide more grant overall in order to soften the impact on the worst-affected households. From a wider point of view, it would have the merit of bearing directly on the problems of individual households.

8. We could, of course, simply wait and see whether DoE come up with any ideas in this area. I suspect, however, that rather than find ourselves having to respond to half-baked ideas a week or two before the RSG decisions, there would be much to be said for investigating this and other possibilities, informally and in-house.

9. We should be most grateful for your guidance both on this point and generally.

AJCE

A J C EDWARDS

lgl.va/fellgett/minutes/trans

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FROM: R FELLGETT

DATE: 23 DECEMBER 1988

[1. MR EDWARDS] agreed w' draft

2. CHIEF SECRETARY

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COMMUNITY CHARGE: TRANSITIONAL ARRANGEMENTS

The proposals in Mr Ridley's minute of 25 November to the Prime Minister (which she accepted on 28 November) are sensible. Although it is not essential that you comment on them, you might like to write briefly to say that you are content.

2. Much more substantively, we have taken this opportunity first to consider, and now to seek your views on, the way in which we should approach the construction of the Community Charge safety net in England (and Wales) over the next few months. This is likely to be a very important part of the grant distribution arrangements over the next few years, and we will need to ensure that it remains self-financing, as always intended. (If it was instead financed by the Exchequer, that would cost about £1 billion.)

The Safety Net

3. The Safety Net was originally conceived as part of a package of measures to phase-in changes in the distribution of grant and business rate revenue to local authorities, and local domestic taxation, as a result of the introduction of the Community Charge system. When the system is fully in place about £1 billion of

grant and business rate revenue (taken together) will have been transferred, roughly from inner London and the North to outer London and the South. Unless local authorities modify their spending, there will be equal and opposite changes in Community Charge compared to domestic rates per head. The CC will be higher in inner London and the North, and lower elsewhere.

4. The Green paper "paying for local government" in January 1986 said:

> "The Government envisages that special arrangements would be introduced to avoid any significant shifts in the burden of local taxation between local authorities on moving to a new system. These arrangements would take the form of a "safety net", which would prevent changes in authorities' income in the first year of the new system arising from the structural changes to the grant and non-domestic rate arrangements proposed in this Green Paper".

It added:

> "The safety net would take the form of ...adjustments to the grant and non-domestic rate allocations of authorities; it would effectively operate as a self-financing pooling arrangement. ....the effect of the safety net would be to preserve authorities' grant and non-domestic rate income in the first year of the new system at broadly the same level as under the present grant and taxation arrangements."

5. In the little yellow booklet "Paying for Local Government: the need for change", published in July 1987 the formulation of the safety net was:

> "There will be a safety net designed to make sure that a local council will need to raise only the same amount [in real terms] from.... Community Charge in 1990-91 as it raised from domestic rates in the previous year, provided that it spends the same amount in real terms in both years. This safety net....will be phased out by 1 April 1994."

6. It was subsequently decided, and announced in November 1987, to amend the operation of the safety net slightly. The safety net would no longer preserve exactly the 1989-90 distribution of business rates and grant income together in 1990-91. Instead, those few areas (eg in Buckinghamshire) that were expected to gain by more than the equivalent of £75 per adult resident from the new system, would receive sufficient gains in 1990-91 so that only £75 per adult of further gains were due in subsequent years. Areas that were expected to gain by less than £75 per adult would be unaffected by this modification. Areas that were expected to lose, would face initial losses of perhaps £3 per adult in 1990-91, to pay for the concession to large gaining areas like Buckinghamshire.

7. Without the other part of the original package of phasing measures - dual running, or moving gradually from domestic rates to Community Charge over a number of years - the rationale for any safety net is less clear. There will be very large gains and losses for individuals immediately in 1990-91. People with above average value accommodation per head will gain, and others will lose up to (in the extreme) about £500. But, apart from the concession to Buckinghamshire etc, there will be no significant geographical gains and losses from the new system. It is, as you and the Chancellor argued at the time, curious (to say the least) to treat geographical changes more carefully than those for individuals. It also has the perverse effect that some individuals will see curious movements in their local domestic taxation, first up and then down or first down and then up, between 1989-90 and 1994-95 when the new system is fully in place.

8. On the other hand, DOE (who deal with local authorities and not people) see nothing wrong with providing stability in 1990-91 in the income of local authorities, even alongside quite large gains and losses among individual local taxpayers. There is also, of course, a political dimension to geography - constituencies are geographical and the Community Charge in any area, compared to average domestic rates previously, may be a key concern towards the end of this Parliament.

Mr Ridley's minute

9. Mr Ridley's minute responded to a request from the Prime Minister that he consider a very different form of safety net. Grant would be diverted to a limited number of areas where the Community Charge in 1990-91 would otherwise be likely to exceed, say, £350. All other areas would pay for this diversion by receiving less grant than they would otherwise be entitled to. In contrast to the announced form of safety net (see paragraphs 5-6), there would thus be a major change in the distribution of grant and business rates together between 1989-90 and 1990-91. There would be further staged changes thereafter, as the safety net was withdrawn. A similar, but more limited, arrangement is planned for Scotland in 1989-90, and the No.10 policy unit (before recent changes in personnel) favoured a similar system south of the border.

10. Mr Ridley says in reply that he does not propose to consider this arrangement now, but will do so when final decisions on the safety net are taken. He envisages taking those decisions alongside the next RSG round in June and July.

11. We agree that it would not be sensible to take final decisions about the distribution of grant in 1990-91 before the total has been settled. Indeed, there may be advantages in settling the total first and considering the distribution (ie mainly the safety net) later, as broadly happens now.

12. Mr Ridley's minute also notes that the formulation of the safety net which has been announced (see paragraphs 5-6), together with closedown of the RSG system, may give authorities incentives to budget for high spending in 1989-90, financed out of balances and low rates. There will be no grant penalty for high expenditure. They might also hope that the safety net would enable them to maintain the same high spending with the same low rates, but without using balances, in the following year. We very much agree that authorities should be shown sufficient alternative formulations of the announced type of type of safety net to prevent them perceiving such an incentive; we are in touch with DOE officials about this.

Possible Safety Nets

13. Any further changes in the form of safety net, compared to that which has already been announced, may provoke complaints from those who had expected to do better between 1990-91 and 1993-94 under the system already announced. This is an argument against any change, to which we previously gave some weight. But the DOE exemplifications of a possible Community Charges each year have changed so often, and the safety net is such an obscure and little understood part of the new system, that we have given some thought to possible alternatives to the announced form of safety net. The legislation gives wide discretion to the Government over the construction of the safety net.

The Safety Net in 1990-91

14. We have considered, first, whether it is still right to use a safety net to prevent (or at least severely curtail) geographical gains and losses from the new system in 1990-91. The alternative would be to introduce some gains and losses in 1990-91. The safety net has, after all, already been modified slightly to allow gains in 1990-91 in the few parts of the country where the eventual gain is expected to exceed £75 per adult. It might be possible to go further. Rather than broadly freeze the distribution of grant and business rates together in 1990-91, at its 1989-90 pattern, one could bring in, say, one quarter of all the gains and losses in 1990-91, rather than deferring them a year. Half of gains and losses could then be completed in 1991-92, three quarters in 1992-93 and all in the following year.

15. The argument for bringing in some gains and losses in 1990-91, is that the Community Charge has been sold in the South and outer London partly on the basis that it would be less than rates for the average household. People in these areas may be expecting quick gains for a majority of residents (ie expecting geographical gains in addition to gains for roughly the half of individuals living in above-average value accommodation). As you will recall, we suspected that much of the pressure in the Autumn of 1987 to

bring in the Community Charge quickly was in fact motivated by a desire to bring in the redistribution of grant and business rate income, rather than simply to replace domestic rates with the Community Charge. Expectations that the Community Charge will mean reductions for the average person in the South (outside inner London) will have been reinforced by recent newspaper stories about the Charge being lower in the South than the North. That will only be true once the safety net has been withdrawn, and not in 1990-91. There may be very strong pressure to fulfil all these expectations by bringing in significant gains for southern and outer London areas quickly in 1990-91, rather than deferring them.

16. It would be preferable to pay for such geographical gains by similarly phasing geographical losses quickly, rather than through additional Exchequer grant.

17. On the other hand, if political pressures will not require significant gains in southern areas, it would be better to stick with the announced arrangement that, with a few exceptions like Buckinghamshire, there will be neither geographical gains nor geographical losses in 1990-91. The forthcoming RSG round is likely to be dominated by the introduction of the Community Charge in England and Wales, including the fact that there will be some quite large losses among individuals. It would be counter-productive to add to those difficulties in the negotiations by accepting also geographical losses in half the country. It would be better to defer losses until later years when the Community Charge will be a little older and the pressures, at least outside election years, to make it popular a little less intense.

18. The choice therefore depends crucially on a political judgement about the extent of pressures for gains in the bulk of the South and outer London in 1990-91.

Quicker Phasing?

19. Second, we have considered whether it is still right to withdraw the safety net (ie phase-in the re-distribution of grant and business rate income together) in broadly four equal steps, beginning either in 1991-92 under the announced formulation or in 1990-91 under the alternative discussed above. Another option would be to phase the changes in three steps, to be completed for 1993-94 or 1992-93 respectively or in two steps, or even in one go.

20. Under the announced four steps, ~~the for losers~~ losses are equivalent in the worst case to £80 extra Community Charge per adult in each of the four years (in Greenwich). The highest Community Charge would rise by the end of the period to around £700, in Camden and Tower Hamlets. With quicker phasing, the annual changes would be bigger and highest Community Charges in London would be reached earlier.

21. Among gainers, significant gains for the few large gainers will appear in 1990-91 even under the announced arrangements, due to the modification for Buckinghamshire etc described above. Remaining gains of up to £75 per adult, would then be phased in in however many annual steps were thought appropriate.

22. Another variant would be to begin the process of gains and losses for all areas in 1990-91, as discussed above, but phase in five equal steps (apart from any special concession to Buckinghamshire etc, to prevent them being worse off than under the announced arrangements) to complete the process in 1994-95, as originally announced.

23. The effect of some options is summarised in annex A.

24. The arguments for faster phasing include:

(i) it allows more gains to accrue to southern and outer London areas in the present Parliament, without additional Exchequer support;

(ii) by similarly phasing losses more quickly, there will be fewer RSG negotiations in which complaints from losing areas will be an argument for extra Exchequer support;

(iii) there will be fewer years in which local authorities can point to the phasing arrangements as a reason for changes in Community Charges, which they can therefore blame more effectively on the Government rather than on their own expenditure decisions;

(iv) there will similarly be fewer years in which local authorities gaining from the new system can put up their spending, rather than reduce their Community Charges, and thereby add to total local authority expenditure. (Unfortunately, the propensity of authorities to raise expenditure as they are given more grant and business rates is greater than the willingness of losing authorities to reduce their spending.)

25. The arguments against faster phasing are mainly:

(i) with larger annual geographical losses, there will be greater pressure to moderate them through Exchequer support in each year of the transition;

(ii) there will be less time for London boroughs, in particular, to moderate their expenditure habits to reduce the very highest prospective Community Charges.

Misleading (wives, adult children etc)

26. On balance, we feel that the arguments against faster phasing are stronger, so long as Community Charges of up to around £700 a year are in prospect. We do not underestimate the difficulties of imposing such high charges on individuals, some of whom will have paid no local domestic taxes at all up to 1989-90. The pressures to deal with them will be intense, and Community Charge capping will be an important, but only partial, answer to the problem because there is a limit to the pressures that can be placed on these authorities, who have some of the weakest management in the country. They will also have to deal with the transfer of education responsibilities from ILEA, as well as all the other reforms planned for April 1990. We could well be faced with strong requests to assist the boroughs directly, or to assist their charge payers through higher levels of income support or housing benefit in some regions (on which we are aware DOE have done some preliminary thinking).

27. There are, however, some modest signs that the very highest Community Charges may not be quite so extreme as earlier thought. Some London boroughs have made genuine reductions in spending as a result of rate-capping. The new needs assessments (GREs) may also recognise higher spending needs in inner London, particularly for education and some other services, and thereby redistribute grant into inner London and moderate Community Charges. But the costs of unwinding creative accounting deals, which broadly deferred loan charges into the 1990s, will go in the other direction.

28. We therefore favour keeping an eye on these prospects, with a view to considering faster phasing if (but only if) the prospect of extremely high Community Charges in London does indeed recede.

The Policy Unit option

29. Third, we have considered the alternative form of safety net, which would distribute extra grant towards those areas where the Community Charge might otherwise be higher than, say, £350. This is at first sight attractive, because it tackles directly the problem of very high Community Charges in 1990-91. It is also

likely in practice to be somewhat similar to the announced type of safety net, mainly because those areas with the highest prospective Community Charges are also those who have had access to substantial business rate income under the present system, which they will lose from the change.

30. It is, however, quite different in conception to the announced approach to constructing the safety net, which can be defended as phasing-in changes and giving local authorities time to react to them. This option would be a blatant subsidy towards those areas who are the highest overspenders. It would be seen as a reward for overspending, contrary to our public expenditure policies. It would also be seen as an unfair diversion of grant from more moderate areas to these high spenders. There would undoubtedly be more pressure to find the extra grant for London etc from the Exchequer, rather than overtly from the rest of the country.

31. We do not therefore favour this approach.

A personal safety net

32. Fourth, we have considered whether it would be possible to review the decision to do away with phasing for individuals. It is clearly not possible to go back to dual running, ie retaining domestic rates in parallel with the Community Charge for a number of years. But it might be possible to devise a form of <u>personal</u> safety net, to go with the safety net for areas. Individuals could be assured that their local domestic tax bill would not go up by more than X% or £Y in 1990-91, or in following years, unless their council increased its spending in real terms.

not on @ this stage

33. At first sight, this looks difficult. It would have, in practice, to operate on households rather than individuals, because the only records of rate payments will be at the household level. There would be problems with people who moved, or whose household circumstances changed between 1989-90 and subsequent years. There might be complex interactions with the Community Charge benefit system. To solve all these problems, we might be pushed back to calculating what the domestic rates would have been, if they had continued to apply. That would be seen by critics as bringing back dual running through the back door. A personal safety net would require primary legislation.

34. Nevertheless, in principle it should be possible to devise a system in which large losers among households were protected, either at the expense of a supplement to the Community Charge for everyone else or by similarly deferring the largest gains among households in the same area. We would, of course, require such a system to be self-financing within each area.

35. We should be grateful to know whether you would like us to think these ideas through a little further, over the next few months. Despite the difficulties, they may prove to be useful if the experiment of introducing the Community Charge in one go, without any phasing for individuals, in Scotland in April 1989 does not go well.

Conclusion

36. A very brief draft letter to Mr Ridley is attached.

37. We do not need to reach final conclusions on our attitude to the safety net at this stage. But our preliminary conclusions are:

(i) Whether we argue for modifying the safety net to allow significant geographical gains and losses in 1990-91, depends on a (primarily political) judgement about whether gains for average residents are firmly expected in the south and outer London in 1990-91;

(ii) We are not at this stage convinced that it would be in our interests to phase-in the full redistribution of grant and business rate income faster than the four steps already announced, but we should consider this option seriously if the very highest Community Charges are unlikely to be quite as large as currently estimated;

(iii) We do not favour the alternative approach to constructing the safety net, previously championed by the No.10 policy unit;

(iv) We should think further about the possibility of a personal safety net, in case something is needed, although there are substantial difficulties.

38. We should be glad to know whether you agree, to inform our preparations for the next RSG round in the coming months.

Robin Fellgett

R FELLGETT

ANNEX A

EFFECTS OF DIFFERENT SAFETY NETS ON CHANGES IN COMMUNITY CHARGES (£ PER YEAR)

Announced scheme

	1990-91	Each Year 1991-92 to 1994-95
Big gainers (eg Bucks)	all gains above 75	19
Other gainers	0	up to 19
Losers	3	up to 80

Variant 1: ¼ of gains and losses brought forward to 1990-91

	1990-91	Each Year 1991-92 to 1993-94
Big gainers	all gains above 94	19
Other gainers	up to 19	up to 19
Losers	up to 81	up to 81

Variant 2: announced scheme for 1990-91, but quicker phasing subsequently

	1990-91	3 steps 1991-92 to 1993-94	2 steps 1991-92 to 1992-93	1 step 1991-92
Big gainers	all gains above 75	25	38	75
Other gainers	0	up to 25	up to 38	up to 75
Losers	3	up to 107	up to 160	up to 320

Variant 3: 1/5 of gains and losses brought forward to 1990-91, phased in 5 steps

	1990-91	Each Year 1991-92 to 1994-95
Big gainers	all gains above 90	15
Other gainers	0	up to 15
Losers	up to 65	up to 65

DRAFT LETTER TO

Secretary of State for the Environment

COMMUNITY CHARGE: TRANSITIONAL ARRANGEMENTS

I was grateful for my copy of your minute of 25 November to the Prime Minister.

I would like to record that I agree fully with your conclusions. We must not encourage local authorities to believe they have any incentive to overspend in 1989-90. I also agree that final decisions about the distribution of grant in 1990-91 should not be taken until we have the latest information, and have reached conclusions on the total amount of grant that will be available.

I am copying this letter to the Prime Minister, other members of E(LF), and to Sir Robin Butler.

[JM]