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CHANCELLOR

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FROM: B H POTTER (LG1)
X4790
Date: 4 August 1989

cc: Chief Secretary
Sir Peter Middleton
Mr Anson
Mr Phillips
Mr Monck
Mr Edwards (LG)
Mrs Lomax (GEP)
Mr Hudson (LG1)

cw/ Helpful to have your views on what approaches look promising (eg Option C?) and which, if any, can be ruled out (Boyson's?). Messrs Potter & Hudson will then put work in hand so that you can discuss sensibly with Mr Potter in Sept.

DJ

POTTER TO CHEX 4/8

THE SAFETY NET

You asked us to consider (by way of contingency planning) how the proposed safety net arrangements for local authority (LA) current expenditure in England might be changed, in the light of the response to the July announcement. This note sets out the options in broad terms; we would be grateful for any guidance on which you think look most promising, so that we can work them up further.

The problems

2. It is helpful to analyse the reasons for the relatively poor reception given to Mr Ridley's proposals by backbenchers on 19 July. The most important point is that the criticism was not directed at the basic AEF settlement or the proposed Community Charge for Standing Spending (CCSS); instead it focussed almost entirely (and sometimes wrongly) on the safety net. And Mr Ridley failed to put across the very respectable case for the existing proposals.

3. At least five separate strands can be identified in the criticisms of the safety net.

a) The increase in the burden of local taxes on particular individuals following the switch from rates to the community charge (CC) (eg Mrs Peacock, MP for Batley and Spen, quoted a typical hard case of a pensioner couple in a low rateable value property); this of course is inherent in the policy and has nothing to do with the safety net.

b) The continuing transfer of resources (or cross-subsidy) between areas of high and low local taxable capacity - ie the reminants of the old system of resource equalisation: Mr Ridley failed to get across that the scale of these transfers would be reduced in 1990-91 relative to 1989-90 and that, overall, the new system involves a switch of resources from North to South.

c) The safety net involves switching resources from prudent LAs to profligate local councils.

d) The safety net blurs identifiable accountability (even though there is full accountability at the margin): because safety netted CCs vary from the CCSS, even for standard spending, it is less easy for sensible council to demonstrate its prudent policies and management to the local electorate, by comparison with a profligate neighbouring council. Once the safety net is gone, the charges will be directly comparable.

e) In some cases, criticism of the safety net may be coded attacks on the community charge system itself.

4. Nothing can be done to resolve problems a) and e) above - now that it is too late to consider some form of dual running with rates and community charge in tandem. The issue is whether we can find some means of recasting the safety net, without excessive additional public expenditure cost, so that it meets at least some of the concerns identified at b), c) and d) above.

Safety Net Options

5. The Treasury's objective must be to minimise the public expenditure cost of any changes to the safety net and ideally avoid any extra cost at all. Looked at more broadly, however, it will be important to get a safety net firmly in place very soon (probably in time for the party conference). And the revised arrangements must be capable of being successfully presented - with DOE making a proper effort to sell the policy.

6. Indeed, against that background, it might be argued that minor tinkering with the existing safety net model, with a few concessions here or there will not be enough. It could end up costing the Treasury more - if it proved inadequate to satisfy the critics. And pressure would have been seen to be successful. A more thorough revision may therefore be worth contemplating. In large part, this is for political judgement. But within LG we have looked at a range of options from minor tinkering to abandonment or fairly substantial reformulation of the safety net.

7. One option we have not considered is anything along the lines proposed by Sir Rhodes Boyson - the Exchequer paying for contributions to the safety net rather than gainers. The cost would be over £600 million. And E(LF) have repeatedly confirmed support for the principle of a self-financing safety net; and - as the experience in Scotland shows - there can be no guarantee that extra Exchequer support even to gaining areas in the South would be reflected in lower CCs. The risks would be higher expenditure; in other words, such a subsidy would have a high "deadweight" effect.

8. Instead we have considered:

- revisions to a self-financing safety net (options A, B and C below)
- abandonment of a safety net as such, while retaining transitional protection via payments of specific grants (option D).

9. An appraisal of four basic options (and a number of variants) is contained in the attached annexes (for which Messrs Hudson and Rutnam are largely responsible). They have, however, been prepared without the advantage of any numbers. In summary, the options are as follows:

A) Tinkering

i) your own point that the inner London grant arrangements should be altered to avoid safety netted-CCs being below the uprated average rate bill per adult: this frees resources to the advantage of gainers; it is clearly desirable whatever other changes are made;

ii) the specific grants for low-rateable value areas (and perhaps ILEA) could be increased

iii) the rates at which gains and losses are allowed through within the self-financing safety net could be increased

iv) the way in which gains (and losses) come through could be reformulated

v) the needs assessment could be revised to help particular areas

B) The levy approach

- the idea favoured by Mr Ridley of setting a common levy on all bills to pay for the costs of safety net protection.

C) Change the basis of the safety net

- this would give no safety net protection for an authority's overspending: the equalisation would be conducted on the basis of the average rate bill for spending at need (GRE) in 1989-90: this would avoid cross subsidy between the prudent and the profligate.

D) Abandon the safety net - several variants are possible: at one extreme, the Government could introduce the community charge with no transitional arrangements at all; rather more politically defensible perhaps are variants which involve continuing with the ILEA and low rateable value specific grants (perhaps increased) as transitional protection, perhaps augmented by other such grants. One such grant might to keep down the very highest charges as put forward about nine months ago by the Prime Minister. (How the cost might be met is explored below.)

The options are not mutually exclusive. Options can be combined in various ways eg option C plus options A i) and iii).

10. Until we have had an opportunity to consider exemplifications on these bases, we are not in a position to recommend options. But in reaching views, it may be helpful to note how the options score in terms of the three problems identified earlier.

11. Option A - Tinkering - can ameliorate b), c) and d) (ref. paragraph 3). But it does not eliminate them: arguably the existence of any contributions to the safety net will still antagonise backbenchers. On the other hand, much can be done to present the existing safety net in a more attractive way: had Mr Ridley taken Treasury advice and included a column in his exemplifications showing the existing average rate bill, <u>per adult</u>, he could have drawn attention to the massive shift of resources under his safety net proposals in favour of the 'complaining' LAs in the South East. The benefits of better presentation of what remains a respectable case should not be underrated.

12. Option B - the levy - does nothing: its equity is illusory (as the annex shows), since contributions will still be made from all gainers and go, in some cases, from the prudent to the profligate.

13. Option C - a new basis for the net would eliminate cross subsidy between prudent and profligate: but it would retain contributions. We are very unsure what the pattern might look like in advance of seeing the numbers.

14. Finally Option D - abandonment of the safety net - removes all three difficulties because it does away with contributions, while nonetheless retaining transitional protection. But unless the scale and coverage of specific grant payments are increased, it leads back to the political problems - particularly losses in the North and Midlands - which underlay the case for the safety net in the first place. And that threatens to be costly.

15. In exploring the options, it will also be desirable to consider another factor - the period of the safety net. Existing policy is that the safety net will last four years. But that period could be reduced: and more rapid withdrawal of the safety net could be very attractive as part of a little change amendment to the form of the net. Again the transitional protection offered by the specific grants could be continued even if the safety net itself were abandoned after one, two or three years. So one possibility would be to make little change to the arrangements for year 1, but with a radical reform (options C or D) from year 2.

Who pays?

16. Several options eg option D would lead to higher costs (in terms of specific grants). There are three possibilities:

i) the cost could be met from within the existing grant settlement, leaving NNDR unchanged;;

ii) the cost could be met from within the existing AEF, by increasing the grant element: this would require NNDR income to be reduced temporarily (see below);

iii) the cost could be met from new money, by increasing AEF.

17. Option i) is best from our point of view; but it may be judged that would not be sufficient to keep the backbenchers content. Option iii) is to be avoided if possible.

18. Option ii) would require action to depress the take from NNDR. It would be necessary to ensure this did not lead to a permanent loss of NNDR income: in short, the NNDR poundage would have to be held down on a transitional basis. The advantage would be that LAs would receive no more resources (ie unchanged AEF), and, arguably, that easing the transition to the NNDR would see off Parliamentary pressure on that front, and, more damaging still, any pressure to reduce the long-term take from business rates. The disadvantage would be that the balance between general taxes (increased) and business rates (reduced) would change. Any decision on this would need to take account of wider considerations of fiscal policy.

Handling

19. I understand that an early September meeting between you, the Chief Secretary and Mr Patten is planned. DOE officials are guarded but may well be working on safety net options. I appreciate that you will wish to consider this carefully and that we are not yet able to supply numbers on options. But Mr Hudson and I will be working further on these options; and any guidance on the merits in principle of different options would be helpful to provide a focus for further work.

Barry H. Potter

BARRY H POTTER

OPTION A: Tinkering with the safety net

Description

Adjust the details of the way the safety net is formulated to produce a better balance between gainers and losers. There could be (at least) four variants of this.

(a) Meeting the Chancellor's point that the ILEA grant should be restructured so that initial community charges were no lower than the 1989-90 rate bill per adult releases around £70 million, which would increase the proportion of gains coming through from, on the latest estimates, 47% to 53%.

(b) Increasing the amount of losses coming through would enable more gains to come through.

(c) Keeping the basic principle that gainers pay for protection for losers, but choosing one of the other options discussed in E(LF) for deferring gains - for example, allowing the first £20 of all gains through would reduce the number of authorities who had to make a safety net contribution at all, at the cost of higher contributions from big gainers; on the other hand, the previous approach of deferring all gains up to a maximum contribution of perhaps £40 would give a better deal for big gainers.

(d) Adjusting the needs assessment could direct more grant to particular areas, not just over the transitional period, but permanently (though in practice, the needs assessment can be revised at any time).

Advantages

1. Little or no extra cost. Some extra cost could arise if the amount of losses coming through generally were increased but Ministers decided to stick to the commitment to no losses in areas of low rateable value (Pendle etc), but the cost of this should only be tens of millions.

OPTION A

2. Consistent with present approach.

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3. Arguably, a loss of £30 (or 60p a week) would not be excessive, especially given special protection for poorer areas.

4. Point (a) justified in principle.

Disadvantages

1. Tinkering on its own, may not satisfy backbench critics, who were objecting to the principle of the safety net rather than the details, and offered no thanks for the changes already announced, which allow more gains to come through in the first year than was previously expected.

Conclusion

We think point (a) is worth pursuing whatever else happens. But further tinkering along the lines of (b) and (c), may not be enough by itself. But it may be worth pursuing as part of a wider package, eg tinkering with the safety net for year 1, with radical reform promised for year 2.

Thanks. Option C clearly needs further work and should be dropped. Option B can be considered, Option A is worth doing alone, as suggested ~~with the~~ re the safety net (as applying for the first year only) & ~~[illegible]~~ [illegible] for years 2 & 3 some (inexpensive) variant of option D.

OPTION B: The "Levy" Approach

Description

Under this approach, each LA is required to make a flat-rate contribution to the cost of protecting "losing" authorities. The figure would be roughly £26 per adult. It would mean that, for standard spending, each gaining LA could set the long-term community charge + £26 per adult,; and each losing authority would pay the average rate bill per adult plus £26.

Advantages

The previous Environment Secretary saw this approach as being perceived as fair - equal misery for all. Everyone both losers and gainers was forced to give up £26 per adult. Moreover the cost (at nearly £1b) was too high to be sensibly met from Exchequer.

Disadvantages

i) Does not eliminate cross-subsidy: within the common £26 per adult figure still transferring resources from one authority to another.

ii) Indiscriminate nature of transfer: prudent authorities transfer money to the profligate (though size of transfers lower than under present regime).

iii) Turns small losers into big losers.

iv) Turns small gainers into losers.

v) DOE say it means increasing the community charge for standard spending (CCSN) by £26 to over £300. (Treasury think this can be got around.)

Conclusion

Not a very promising revision. Nature of common levy would be seen through. Danger of pressure on the Exchequer to meet the costs.

OPTION B

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OPTION C: No Safety net protection for overspending

Description

1. The basic aim here would be not to give safety net protection for the extent of a council's overspending, to meet the criticism that the present safety net means that prudent authorities are subsidising profligate ones.
2. Very broadly, the present safety net provides that the community charge in each authority should be no more than £25 higher than the 1989-90 actual rate bill per adult (uprated for inflation), assuming a given increase in spending over actual 1989-90 spending. So if an authority is overspending, the safety net delays, among other things, the time when the full consequences come home to charge payers.
3. A way round this might be to reformulate the safety net along the following lines:

   (a) work out the average rate bill per adult if the LA spent at GRE in 1989-90;

   (b) uprate this for inflation;

   (c) work out the long run community charge if the LA spent at need in 1990-91 - this would, by definition, be the nation-wide community charge for standard spending (CCSS) of £275;

   (d) if (c) is higher than (b) by more than £25, the authority would still qualify for safety net grant.
4. We need to do further work on the technicalities of this, to make sure that it produces a sensible result across the board. But some approach to stripping out overspending ought to be possible.

Advantages

1. Concentrates safety net protection on the structural changes in the system (new approach to grant distribution, new system of business rates, new needs assessments).
2. Improves accountability: Local authorities and charge payers have to face up to the full consequences of overspending straight away.

OPTION C

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3. Should appeal to backbench critics, whose main attack has been that the safety net bails out overspenders at the expense of the prudent.
4. Gains come through quicker (subject to working through the details).

Disadvantages

1. Likely to raise difficult technical questions about definitions etc.
2. Scheme is conceptually simple, but bound to be complicated in practice.
3. Will not satisfy those who want no safety net at all.
4. May mean very high charges and steep increases, in a number of areas. May need higher grant to mitigate this, meaning either extra costs, or safety net protection in another form.

Conclusion

This needs a lot more work, to see if it is viable. But we think it is worth pursuing further, if you see attractions in it.

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OPTION D: Abandonment of the safety net

Description
Abandon the safety net altogether.

Advantages
1. No cost (subject to disadvantages 3-4 below)
2. Would mean full accountability of community charge came in straight away.
3. Full benefits for gainers straight away.
4. Would probably satisfy Tory backbench critics.
5. Some Tory losers (including Mr Trippier in Rossendale) would prefer to get the losses over with in one step, rather than have a series of increases in the community charge, as the safety net is phased out.

Disadvantages
1. Government has said many time that safety net would give losers time to adjust.
2. Scale of adjustment massive, in some cases. To take examples, from 1989-90 published exemplifications, charges would be around £200 above rate bill per adult in parts of Inner London, £70-100 higher in much of West Yorkshire, and £50-100 higher in County Durham.
3. This would lead to pressure for extra grant to maintain something like the expected degree of transitional protection: either specific grants to help losing areas; or higher RSG, to try to bring down CC everywhere.
4. Whether or not there was extra grant, higher CCs in poorer areas would certainly lead to higher spending on CC rebates.

Conclusion
Abandoning the safety net altogether would be a welcome simplification, and would please most of the backbench critics. But the scale of adjustment looks too much to bear without extra grant, so there could be extra cost in paying for any transitional protection. And the Government could be accused of bad faith in breaking its commitments to the losing areas.

OPTION D

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FROM: D I SPARKES
DATE: 7 August 1989

MR B H POTTER (LG1)

cc PS/Chief Secretary
Sir P Middleton
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Mr Phillips
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Mrs Lomax (GEP)
Mr Hudson (LG1)

THE SAFETY NET

The Chancellor was grateful for your minute of 4 August concerning possible modifications to the safety net arrangements recently announced by Mr Ridley. He commented that Option C clearly needs to be worked up further. Option B can be dropped but Option A is worth considering on the basis you suggested, ie as part of a wider package in which the safety net is tinkered with in the first year and radical reform is promised (an inexpensive variant of Option D) for the later years.

DIS TO POTTER 7/8

D.C.S.

DUNCAN SPARKES

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