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P.0965

PRIME MINISTER

Local Taxation
(E(LF)(83)2 and 3)

BACKGROUND

At their meeting on 20 January, the Cabinet decided that the recommendations in the report of the Ministerial Group on Local Government Organisation and Finance (MISC 79) for reform of the domestic rating system were an inadequate response to the needs of the situation (CC(83)1st Conclusions, Minute 7). You said that you would arrange for the issues to be considered further; the Ministerial Sub-Committee on Local Government Finance, of which this is the first meeting, has been set up for the purpose.

2. The broad thrust of the discussion of local rates on 20 January was as follows:

a. Local rates could probably not be abolished, certainly in the short term, and perhaps indefinitely.

b. It was, however, necessary to limit their burden.

c. This would entail one or more of: giving local authorities additional sources of revenue; relieving local authorities of some of their statutory obligations; and taking more responsibility to central government, whether by transferring responsibility for some local authority services or by the central Government's defraying a larger proportion of local authority expenditure. There might also need to be more central control of expenditure by individual authorities.

3. The memorandum by the Secretary of State for the Environment (E(LF)(83)2) concentrates on changes in the way in which local authorities



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raise their revenue. For the longer term it proposes a ceiling on rate poundages; local authorities would be able to raise additional revenue by levying a local sales tax (LST). It is not clear from the memorandum whether all local authorities down to district level would have this ability, or whether it would be confined to upper-tier authorities (essentially, the counties) as suggested in the Green Paper "Alternatives to Domestic Rates" published in December 1981.

4. A LST could not be effective before April 1987 at earliest (this is the date suggested in the Green Paper: since then, time has passed; and April 1988 may be a more realistic estimate). If the rates freeze is to have immediate effect it will be necessary to devise an interim scheme to cover the intervening period. The memorandum proposes an arrangement under which central Government would make good the whole of any gap between rate income (plus fees and other minor items) and an approved level of expenditure. In principle, this means setting an approved level of expenditure for around 500 local authorities in Great Britain. That would be a formidable task: MISC 79 concluded that even a more limited scheme, designed to bite on only 20 or 30 high-spending authorities in England, raised too many problems to be desirable. Paragraph 24 of E(LF)(83)2 therefore hints at an alternative of not limiting rates until the LST can be brought into effect.

5. In E(LF)(83)3 the CPRS argue that the proposal to use LST, which is less visible and painful than rates, to finance marginal increases in local authority expenditure may run counter to the Government's objective of reducing local government spending; that controlling local authority expenditure would be a severe diminution of local government autonomy; and that the right course might be to use LST to finance part of local authority expenditure but to use domestic rates to finance the increase.

MAIN ISSUES

6. You will clearly not want the Sub-Committee to get into too much detail at this stage. The main issue is to judge whether a scheme broadly on the lines put forward by the Secretary of State for the Environment meets



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the Government's policy objectives and is likely to be politically attractive.
The discussion might then focus on some of the more important specific
issues as a basis for future work, ie:

- what if any control of local authority expenditure should be envisaged and how permanent should it be?
- should the Exchequer take responsibility for funding some local authority expenditure (eg teachers' pay)?
- should all categories of local authority have access to LST? should tax rates be set only on a county basis? how do the proposals fit in with the Government's provisional intention to abolish the metropolitan counties?

Broad judgement about the proposals

7. The main advantage of the Secretary of State's proposals is that they would permit the Government to say that it will impose a ceiling on rates which are an unpopular tax. The main disadvantages are:

- a. the introduction of a new tax;
- b. the fact that the particular tax chosen, LST, will tend to increase prices (albeit marginally over a wide range of goods and services) and will inhibit the Government's ability to draw revenue from VAT;
- c. the risk that the new tax will encourage more local government spending;
- d. the difficulty that the new tax is unlikely to be introduced before 1988;
- e. the need either to postpone the ceiling on rates until 1988 or to introduce before then a scheme for giving more financial help to local authorities with a tight control of local authority expenditure.



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8. The Sub-Committee will want to consider the broad balance of advantage and disadvantage. Both the Chief Secretary, Treasury and the CPRS are likely to express concern that introduction of a new source of local authority revenue (especially of a less perceptible kind) may merely add to local government spending and that the more important objective should be to control the latter. This may lead the Chief Secretary to argue for a permanent control on local authority expenditure either as a substitute for the introduction of LST or as a supplement to it. The arguments about the resulting loss of local autonomy are well known. This leads the CPRS to argue for using LST to take the first slice of local authority spending and for keeping the rates to finance the increase. The difficulty with the latter proposition is that it would not avoid regular rate increases; arguably rate increases would still be unpopular even from a lower base.

9. If the Sub-Committee feels that it wants to bring rate levels down without the odium of introducing a new tax, one way of doing this would be to transfer responsibility for financing some part of local government expenditure (eg some or all of education) to central Government. This would have to be combined with some means of restricting local government rating powers or expenditure. Such a proposal would raise very difficult issues about the relationship between central and local government, but it may be argued that these issues arise also on the Secretary of State's proposals.

Control of local authority expenditure

10. If the Sub-Committee decides that control of local authority expenditure should be a feature of the proposals, either for an interim period until a new source of revenue is introduced, or more permanently, the form of such a control will need to be considered carefully. The scheme outlined in paragraphs 18 and 19 of the Secretary of State's paper would appear to involve detailed scrutiny of the budget of all local authorities. It must be doubtful whether this would be practicable, even for an interim period. An alternative would be to try and devise a system of control of only the highest-spending authorities, such as that advocated by the Chief Secretary in the MISC 79 discussions, but further examination would be needed to establish its feasibility.

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Exchequer funding of local authority expenditure

11. If the Sub-Committee takes the view that one element in the proposals should be Exchequer funding of some part of existing local authority expenditure, the possibilities will need to be examined. The options discussed in the paper include teachers' pay, the whole of the education budget, or the police service (already supported by a 50 per cent specific grant). All raise some difficult issues of general policy.

Access to LST

12. If LST is to be an element in the proposals the Sub-Committee will need to take a view on whether it should be available to all tiers of local government or only (as the Green Paper suggested) to the upper tier. Unless LST is available to all local authorities, the rates ceiling cannot apply to all of them. If however the rate of LST varied at the district level, the costs of administration would be high. Moreover, particularly in metropolitan districts, there would be extensive cross-border shopping and this would eventually be a source of much friction and controversy, not least from those who could not engage in it, such as the immobile.

13. The alternative would be to have the rate of LST fixed at the county level, allowing all local authorities to have access to it. The problem is that there would be a loss of accountability; an extravagant district could impose costs on the inhabitants of another district in the same county. Moreover there is a particular difficulty arising from the provisional intention to abolish the metropolitan counties. It could be argued that it would be wrong to allow the joint boards or committees running the services at the county level in metropolitan areas to set the rate of LST since they would not be directly elected.

Timetable

14. Paragraph 24 of E(LF)(83)2 suggests that officials should be instructed to put forward more developed schemes for consideration by the Sub-Committee



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no later than the end of March. The feasibility of this timetable will depend on how far the Sub-Committee can reach a clear view on what the main elements of the proposals should be. It may be useful for the Sub-Committee to reach some preliminary view on what the nature and timing of the end-product should be. Is the aim to have a Green Paper and, if so, when?

HANDLING

15. You will wish to ask the Secretary of State for the Environment to introduce his paper and then to invite comment from the Chief Secretary, Treasury. All members of the Sub-Committee are likely to want to contribute. You may wish to give Mr Sparrow the opportunity to enlarge on the CPRS paper.

CONCLUSIONS

16. You will wish the Sub-Committee to reach conclusions on the following:
- i. should there be a ceiling on rates, combined with the introduction of local sales tax (LST) as a supplementary source of revenue for local government?
 - ii. should this be combined with a control on local authority expenditure, either in the interim before LST is introduced, or permanently?
 - iii. should there be Exchequer funding of some existing element of local authority expenditure and, if so, which element?
 - iv. if LST is to be introduced, should it be available to all local authorities or only the upper tier? should there be different rates at district level, or only at county level?

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v. what further work should be put in hand, within what timetable?

vi. should the aim be to produce a Green Paper and, if so, when?

PLG

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15 February 1983

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