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David Norgrove Esq
Private Secretary to
The Prime Minister
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10 December 1987

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Dear David,

A BANDED COMMUNITY CHARGE: PROPOSAL SUPPORTED BY SIR GEORGE YOUNG ET AL

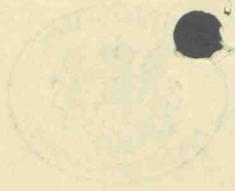
At this morning's Cabinet, my Secretary of State agreed to circulate a briefing note containing the main arguments against the proposal for a banded community charge.

I enclose a note, and I am copying this letter to the Private Secretaries of other Cabinet Ministers, with a request that they make copies available to Ministers in their Departments. I am also sending copies to Murdo Maclean in the Chief Whip's office, and to Trevor Woolley in Sir Robert Armstrong's office.

Yours,
Robin

R U YOUNG
Private Secretary

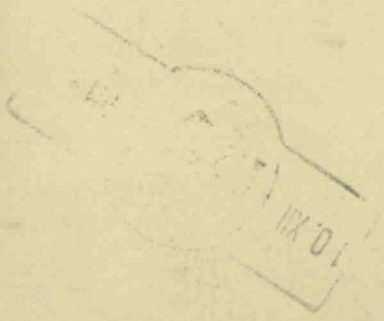
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TOP PRESS: THIS BRIEF WAS PREPARED ON THE BASIS OF CIPFA'S FIGURES. WE HAVE SINCE DISCOVERED THAT CIPFA HAVE SERIOUSLY MISCALCULATED THEM. MOST OF THE REFERENCES TO LEVELS OF BANDED COMMUNITY CHARGE ARE HUNDREDS OF POUNDS TOO LOW. CORRECTED FIGURES WILL BE PRODUCED AS SOON AS POSSIBLE.

THE BANDED COMMUNITY CHARGE - MAIN ARGUMENTS AGAINST

A banded community charge is completely inconsistent with our manifesto commitment to introduce a flat rate community charge with limited exemptions and rebates for people on low incomes. In fact the banded charge is really a Local Income Tax by another name. The arguments against it are numerous and powerful:

- In one important sense it would be even worse than a Local Income Tax. Under one published proposal someone earning an extra £1 of income could end up paying an extra £1,000 of banded charge. This would be an earnings trap with a vengeance;
- There would be huge differences between banded charges in neighbouring local authorities. For example someone with a net income of £8,000 might pay well over £1,000 more in Camden than in Barnet. Someone earning a net £30,000 might pay a stunning £6,000 more in Camden than in Barnet. The result would be a flight of the young and enterprising away from high spending inner city areas, accelerating the spiral of decline;
- The result of this would be serious falls in house prices in areas with high banded charges. So better off home owners in these areas would face a triple penalty: crippling banded charge payments; enterprise traps; and large falls in the capital value of their homes;
- A banded charge would not improve accountability at all. Under one published scheme only 18½ million people would pay anything at all, scarcely more than pay domestic rates;
- Even for those who did pay, the link between what they paid and how much the council spent would be extremely tenuous. Their charge might go up not because council spending increased but because their income had increased by a few pounds;
- Accountability would be further weakened because a complicated system of resource equalisation would almost certainly be needed to iron out differences in average incomes between areas. Without such a system high spending areas would be obliged to levy heavier and heavier burdens on fewer and fewer people; and
- A banded charge system would be more complicated to operate than the community charge. Both systems would require a register of people's sole or main residences. This information is not available in the Inland Revenue. On top of that information on people's incomes would have to be gathered centrally and passed to each local authority. A system of resource equalisation would also be needed (see above).

For all these reasons it is clear that a banded community charge will not meet the Government's manifesto commitments to introduce a simpler, fairer and more accountable system of local government finance. It would not be an improvement of the Government's proposals. On the contrary, it would wreck them altogether.

A BANDED COMMUNITY CHARGE

Most people now accept that domestic rates have to go. The debate has now moved on to what to put in their place. The Government set out its own proposals for a new flat rate system of Community Charge in the 1987 Conservative Party election manifesto. Mr Tony Travers, a London University academic, and Miss Rita Hale of the Chartered Institute of Public Finance and Accountancy have published the only comprehensive set of proposals on how a banded charge system might work. The figures contained in this brief are calculated on the basis of those proposals. However, these CIPFA's figures seriously underestimate the level of charges for all bands of income. To give one example from CIPFA's Press Release, the married couple from Buckinghamshire would pay not £268 but more like £670. This is because of a substantial error in the CIPFA Study arising from a confusion between total incomes and taxable income. Information on which to base accurate calculations is not immediately available, so we are making do for the time being with CIPFA's figures.

What is clear is that, despite the name, these proposals have far more in common with a Local Income Tax (LIT) than with the Government's proposed Community Charge. Indeed the Leader of the SDP recently put forward the banded community charge as a step on the road to an LIT. People who do not pay income tax would presumably not pay the banded charge. There would also be different rates of charge for different levels of taxable income. The only difference between banded charge and LIT would be that people who moved into a higher income band would find themselves liable to a higher level of charge. Under LIT there would be only one rate of tax.

The objections to a system of banded community charge are powerful:

- A new and pernicious earnings trap would be created. Take the example of a person whose income increases. This might take him into the next income band for the community charge. He would then have to pay an extra amount of local tax. This could be significantly more than the increase in his earnings. On CIPFA's own figures, someone in Durham whose net income went up £1 to £10,000 would have to pay an extra £347 in banded charge. Someone in Camden whose net income increased from £14,999 to £15,000 would have to pay an extra £1,000 or more. These extraordinary and perverse effects would exist whichever system of banded charge was introduced.

- Levels of banded charge in high spending areas would be very high indeed. People on average earnings living in these areas would almost certainly pay more than under the Community Charge. CIPFA's own figures imply that a person living in Camden with a net income of only £8,000 would pay £1,000; someone with a net income of £12,000 would pay £3,000; and someone with a net income of £20,000 would pay £6,000. An experienced staff nurse living in Camden could pay £1,200, whilst a senior nursing sister on top of her scale could pay over £2,000. That compares with a Community Charge bill of £782 if the Government's system were fully in operation.

- There would be huge differences between banded charges in neighbouring local authorities. For example someone with a net income of £8,000 might pay over £1,000 more in Camden than in Barnet. Someone earning £30,000 net might pay £6,000 more in Camden than in Barnet. So just as with LIT, the residents of high spending areas such as Camden, Lewisham and Lambeth would have a tremendous incentive to move to nearby areas where charges would be far lower. The consequences would be disastrous. People on moderate to high incomes would be driven out of high spending areas, accelerating the spiral of inner city decline.

- As people moved away from high spending areas the result would be substantial falls in house prices. Better off home owners in Camden, Lambeth and other high spending areas would face a triple penalty: very high banded charge payments, unique enterprise traps, and large capital losses in the value of their homes.

- A banded charge would not restore local accountability. Under CIPFA's proposals only 18½ million people would pay anything at all. Of these several million would pay a flat rate £50 which would not vary from area to area. So a total of up to 20 million people out of 35 million local voters would have no direct financial stake in the spending decisions of their local authority. So there might be even less accountability under a banded community charge than there would under the current domestic rating system.

- Even for those who did pay a local variable charge, the link between what they pay and how much their council's spend would be very tenuous indeed. An individual's charge might go up because council spending increased. Alternatively it might go up simply because his income increased by a few pounds. Accountability would be further eroded because a complicated system of resource equalisation would almost certainly be needed to iron out differences in average incomes between areas. This is explained in more detail below.

- A banded charge system would be a great deal more complicated than the Government's proposals. Under the banded charge system a council like Camden would find its ability to raise income declining as better off people fled the borough to escape the high charges. The consequences would be a greater and greater burden on fewer and fewer people. A further spiral of decline would be created.

- So some system of resource equalisation would be needed in order to make it work at all. This would be rigged to ensure that local authorities were able to raise the same amount of money so that they could provide a standard level of services. It would mean resurrecting the old system of taking from "richer areas" to give to "poorer areas" which has been such a disaster in the past. Charges would vary not just according to local spending but also according to the vagaries of resource equalisation. This is exactly the problem that bedevils the domestic rating system.

- CIPFA do not suggest a system of resource equalisation and the results speak for themselves. Someone earning £8,000 net in Bedfordshire would pay £397, whilst someone earning £8,000 net in Durham would pay £694. Yet local spending is very similar in both areas. The difference arises solely because Bedfordshire is a richer area than Durham.
- Yet the result of introducing a system of resource equalisation would mean that Camden for instance, would get more and more grant as fewer and fewer charge payers remained. So Camden would be able to soak the better off in other parts of the country in order to pay for its own overspending. The Government's proposals on the other hand ensure that every council in the country will be able to charge the same amount if it offers a standard level of service.
- A banded charge system would also be administratively far more complex. A register of each taxpayer's sole or main residence would be needed for a banded charge system, contrary to CIPFA's claims. Although the Inland Revenue have the addresses of many tax payers, they do not have information about sole or main residence. The famous computers would be of no help in this respect.
- More importantly, a banded charge would involve a significant degree of extra complication. Information on people's incomes would have to be gathered centrally and passed to each local authority. This would be a difficult and time consuming task, particularly since accurate information on people's incomes (especially on the self-employed) is frequently not available until two or more years after the end of the tax year. The CIPFA system implies that someone who earned £20,000 and then lost his job would have to go on paying the banded charge for two more years, as if he was still earning £20,000.
- A banded charge would have all the disadvantages of a Local Income Tax but would also create a perverse earnings trap all of its own. It would not achieve the Government's objective of proper accountability. At least 15 million adults would not pay it (under CIPFA's proposals even more) and the grant system needed for its implementation would ensure that some areas were penalised in order to pay for the over-spending of others. It is not an improvement on the Government's proposals, fails to eliminate the defects of the present rating system and introduces new and unique deficiencies of its own. It fails to achieve either fairness or accountability and is completely inconsistent with our manifesto commitment.

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