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Prime Minister
You will want to see
this before the Cabinet
discussion on the RSG orders

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PRIME MINISTER

Tomorrow afternoon we will be laying before the House a series of reports which together form the basis of the local authority grant settlement for 1990/91. These will be debated on the 18th January, and I thought it would be useful to you and Cabinet colleagues to have the enclosed brief.

David Hunt will be sending the same brief, with a personally topped and tailed letter, to all our colleagues in the House of Commons tomorrow.

Last week we announced the details of our information campaign about the availability of Community Charge benefits and you have probably seen the advertisements which are now appearing in the newspapers and on television and radio.

We are making clear our determination to ensure the maximum possible take-up of these benefits, which are much more generous than those presently available under rates and for which a quarter of all Charge payers will be eligible. We are also publicising the Transitional Relief Scheme which was announced at the Party Conference in October. This is designed to provide additional protection for ratepayers, pensioners and disabled people facing large increases during the change-over to the new system.

As the introduction of the Community Charge in April approaches we are determined to win the argument about this major new reform and to give the maximum possible help on the Party net to all our Parliamentary colleagues and to local Conservative councillors.

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We are also stressing to all colleagues that they should contact me, David Hunt or Chris Chope if they feel they need any further information. This, of course, applies to Cabinet colleagues as well.

I am copying this to all members of Cabinet, to the Chief Whip and to Sir Robin Butler.

A handwritten signature in blue ink, appearing to be 'CP'.

CP

10 January 1990

THE 1990/91 LOCAL AUTHORITY GRANT SETTLEMENT FOR ENGLAND

INTRODUCTION

Today (11th January) the Secretary of State for the Environment laid before the House the five reports which together form the basis of the local authority grant settlement for 1990/91.

He also announced that in order to ensure that authorities have adequate cash flow at the start of the system £2.373 billion (25%) of this grant will be paid in April and May. This is about £800 million more than they might have expected to receive in these two months - a cash flow advantage worth £180 million to local authorities.

KEY POINTS

- * Tight control of public expenditure over the last decade has produced economic success:- it has enabled the Government to cut income tax from 33p to 25p, to reduce the national debt so that interest payments are £15 billion a year less than they would have been if borrowing had stayed at 1979 levels and to lay the foundations for 8 years of sustained economic growth.
- * Restraint on Local Authority spending is an inescapable part of the overall control of public expenditure: local authorities' revenue expenditure accounts for 21% of general government expenditure and has grown by 19% in real terms over the last 10 years.
- * The 1990/91 grant settlement is reasonable: the amount the Government believes it appropriate for local authorities to spend is 11% greater than the ^{comparable} figure for 1989/90, on top of a 9.9% increase in 1989/90 over 1988/89; and Aggregate External Finance in 1990/91 to local authorities - from Government grants and business rates - will be 8.5% above the comparable figure for 1989/90.
- * The new grant system benefits many shire areas through the abolition of resource equalisation (these areas will receive half their gains this year and all the rest next year). Many inner city areas benefit by increasing the provision for Additional Educational Need.
- * The Uniform Business Rate provides a statutory guarantee that the business rate poundage in England will in future rise by no more than inflation; since 1974 average business rate poundages have increased much faster than inflation. Changes in individual annual rate bills as a result of the new system will be limited to ease the transition.

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- * The actual level of Community Charges will be set by local authorities. Where the Charge is higher than £278 (before the safety net) this is because local authorities have decided to spend more than the Government thinks necessary to provide a standard level of service, either to provide a higher standard of service or because of inefficiency. The new accountability brought by the Community Charge will rightly require local authorities to justify higher levels of Charge to their Charge Payers.
- * The Community Charge payer should not have to find any more than 23% of the total cost of local government if councils spend in line with our assumptions. Of the £32.8 billion Total Standard Spending level for 1989/90, £23.1 billion will be provided by businesses and Government grant, and about £2.2 billion in Charge benefits and Transitional Relief will be met by the national taxpayer leaving only £7.5 billion out of the £32.8 billion to be met by the Charge.
- * Community Charge Benefit will be more generous than rate rebates. Around one in four Chargepayers will receive it. Community Charge benefit will be related to the actual level of Charge.
- * Transitional Relief will cover the difference above £3 a week between assumed levels of charge and last year's rate bills for households, with additional protection for the elderly and the disabled. It will be available in all areas, whatever the level of local authority spending, although any extra spending above Government assumptions will not be covered by Transitional Relief.

THE 1990/91 LOCAL AUTHORITY GRANT SETTLEMENT FOR ENGLAND

A BETTER SYSTEM

The introduction of the Community Charge in April will usher in a fairer and better new system of paying for local government. Domestic rates will be abolished because:- it is unfair that local services should be paid for by a tax on property values which bear little relation to peoples' ability to pay; - more than 40% of homes with above average rateable values are occupied by households with below average incomes, - and under rates millions pay nothing in local bills for the local service they vote for.

Many of the poorest will benefit from abolishing rates. Four out of five single pensioner households and nine out of ten one parent families should pay less with the community charge than with rates.

A generous system of Community Charge benefit, which about one in four Chargepayers will receive, will protect the less well-off. Transitional relief will be available for households facing large increases in bills as a result of the change-over to the new system, and special help will be available to elderly and disabled people who did not previously pay rates. They need not face increases above £3 a week if their local authorities budget in line with Government assumptions.

The Government will provide Community Charge benefit and related Income Support payments will be worth at least £1.85 billion in 1990/91. The Transitional Relief scheme will cost around £700 million over 3 years and will benefit 9 to 10 million people.

The community charge will lead to greater accountability and will strengthen local democracy, because more people will pay and because there will be a closer and clearer link between spending and the amount of the charge.

THE UNACCEPTABLE ALTERNATIVES

If rates had been retained, a domestic rate revaluation - the first since 1973 - would have been unavoidable. There would have been big rises in rate bills in areas where house prices have risen fastest - particularly the South East. Pensioners on fixed incomes in these areas would have been very severely hit. In the Scottish revaluation in 1985 (only 7 years after the last) over 100,000 households saw bills increase by a third or more.

Labour's alternative - two taxes to replace one - attracted severe criticism, not least from Shadow Environment Secretary Bryan Gould's own constituency Labour party, which called it "unacceptable" in a resolution to the 1989 Labour Conference. It has now apparently been withdrawn for further considerations.

A FAIR GRANT SETTLEMENT

The Government will continue to provide very substantial Exchequer support for local authority spending next year. Final details of the 1990/91 Grant Settlement were published today (11th January). The main features are:

(i) Total Standard Spending - that is the amount Government thinks it appropriate for authorities to spend - is £32.8 billion. This is an increase of £3.3 billion or 11% over the comparable figure for 1989/90. This is on top of a 9.9% increase in 1989/90 over 1988/89;

(ii) Aggregate External Finance - from Government grants and business rates - is £23.1 billion, an increase of £1.8 billion or 8.5% over the comparable figure for 1989/90. This is on top of a 8.9% increase in 1989/90 over 1988/89;

(iii) This leaves about £9.7 billion to be found from community charges - an average charge of £278.

After allowing for a further £2.2 billion of support for individuals through benefits and transitional relief, charge payers will be paying only £7.5 billion towards expenditure of £32.8 billion - less than a quarter (23%) of the cost. If local authority spending is higher than this, the actual proportion of spending paid for by the charge will rise - but benefits will be tied to the actual level of charge.

A SIMPLER GRANT SYSTEM

The change to the community charge with its improved accountability has made it possible to simplify the grant system. The new system reflects four factors:

(i) the end of the previous unfair and unpopular subsidy from areas of high rateable value per head to areas of low rateable value;

(ii) the change from Grant Related Expenditure assessments (GRES) to Standard Spending Assessments (SSAs);

(iii) the switch to the uniform business rate;

(iv) the end of the link between spending and grant.

Transitional arrangements apart, grant will be paid so that the community charge in every area would be the same (ie £278 in 1990/91) if each authority provided a standard level of service.

Grant will no longer vary with expenditure. Grant for each area will be fixed before the year begins. Councils which are more efficient than the average will need to raise less from their chargepayers, and so can set a lower community charge.

Conversely, Councils which are inefficient or which provide services at a higher standard, will need to raise more from their chargepayers. In this way much greater accountability will be achieved. Extra spending falls £ on £ on the charge.

THE STANDARD SPENDING ASSESSMENT

The Standard Spending Assessment (SSA) for each Council is the estimate of the cost of providing the standard level of service, taking into account the characteristics of each area.

The old system of GREs was complex and incomprehensible and involved over 60 separate assessments. The new system is much simpler and reflects extensive discussion with local authorities and detailed research. There are 13 components, reflecting the main services.

Some major changes compared with GREs are:

- * greater weight on sparsity, helping many rural areas;
- * greater recognition of the cost of providing services (particularly education) in London and the South East;
- * greater recognition of the cost of educating pupils with additional educational needs;
- * a large number of smaller services are now covered by one assessment (the Other Services Block). Within that assessment, there is greater emphasis on density and on social factors.

The marginal shift away from shire areas because of the increased provision for additional education need is more than countered by the ending of the subsidy from high rateable value areas, which particularly helps the Home Counties.

THE SAFETY NET : REMOVING AN UNFAIR BURDEN

For decades areas with high rateable values have unfairly subsidised areas with lower rateable values. The new system makes abolition of this unfair burden possible. Areas which stand to gain from the new system will get half their gain in the first year, and the full gain from the second year onwards. It is only fair that they should defer part of their gain for a short period to help areas which lose from the reform.

Losing areas will be protected for four years - with protection in the last three years funded by the Exchequer at a cost of £850 million. The safety net is not a subsidy from prudent to profligate authorities. (Liverpool and Manchester, for example contribute to the net, but Wandsworth and Bradford receives from it). There are also special grants for areas with very low average domestic rateable values, and for London boroughs taking on education functions.

THE UNIFORM BUSINESS RATE

The business rate changes have two components: a single rate poundage for the whole country; and the first revaluation since 1973. Overall, as the Government pledged, the burden on existing businesses next year will raise broadly the same amount in real terms as this year under the existing system. The rate poundage of 34.8 pence for England in 1990/91 is less than business was expecting.

Revaluation is essential to remove the distortions caused by the present use of out dated and hence unfair 1973 values; almost 75% of the total shift in rates burden under the new system is attributable to revaluation.

Even the Labour Party supports revaluation. The then Shadow Environment Secretary said during the passage of the Local Government Finance Act 1988, "We support the revaluation of business property, because we are in favour of a property tax" ('Hansard' Standing Committee, 3rd March 1988, Col 1186).

The changes will benefit businesses in the Midlands and North by reducing their 1989/90 rate burden by around £900 million in real terms when the changes are fully in place. This will help to reduce economic and development pressures in the South and South East.

The single rate poundage will remove the distortions caused by the wide variations between locally fixed poundages under the present system. It will protect unrepresented business in some areas from having to bear an unfair share of high spending.

Above all, every business will have the statutory guarantee that the poundage will rise by no more than the general rate of inflation and possibly by less, giving business a stable basis on which to plan. By contrast, under the present system there has been a real terms rise averaging 1.3% in each year since 1974 in business rate poundages.

PROTECTION FOR LOSERS

Of course, there will be losers as well as winners under the new system. If the previous system had been retained, rate rises next year would have left virtually all businesses as losers. The new system includes transitional arrangements which will phase in large increases, paid for by slowing down reductions in bills.

No rate bill will rise by more than 20% a year in real terms during the 5 year transition period and for the roughly three quarters of businesses which have small properties (below £10,000 new rateable value and £15,000 in London) rises will be limited to 15% a year in real terms.

Chris Patten will be writing to all businesses in England next week to explain the new business rate system, and in particular the transitional arrangements.

QUESTIONS AND ANSWERS

Q. Has the Government not steadily reduced the proportion of local spending paid for by Government grant?

A. Local authorities have done well in the past. Over the last five years, local authority spending has risen by nearly 10% in real terms while Central Government spending has risen by only 3.4%. It is true that under a trend begun by the last Labour Government in 1976 the national taxpayer's share of local authority expenditure has fallen from 66% to 42%. This reflects decisions by successive Governments to strengthen local democracy by increasing the proportion of local spending paid for locally.

Q. Why are you only allowing for a 3.8% increase in local authority spending?

A. For 1990/91 the Government has increased the amount it believes appropriate for local authorities to spend by 11% and Aggregate External Finance by 8.5%

The figure for Total Standard Spending is £1.2 billion or 3.8% above the amount authorities are planning to spend in 1989/90. However, the Government do not accept that 1989/90 budgetted spending represents the right point from which to start.

Authorities budgetted in 1989/90 to increase spending by about 9%, and there can be no automatic acceptance of that overspending. Local authority overspending this year has used up three quarters of the government's substantial contingency reserve. Moreover, in recent years authorities have always spent below their budgets on a range by £200 million, and the Audit Commission have identified scope for savings worth £550 million a year.

Q. Why have you not taken account of the use of balances in the settlement?

A. Some authorities have argued that their rate in 1989/90 - which is the starting point for calculating safety net receipts and contributions - was held down by using balances and reserves. They say they cannot do the same again in 1990/91, so that the illustrative charges published by DOE are too low. This argument is misleading because:

(i) in calculating the average charge of £278, there is no assumption that balances can be used again;

(ii) in calculating assumed charges, DOE did start from 1989/90 rate income and grant (so leaving out of account expenditure financed from balances or reserves) but there are good reasons for this:

(a) in the past the actual reduction in balances in aggregate has always been less than the budgetted figure;

(b) even if authorities do use balances as planned, in aggregate they will still have £1 billion available at the start of 1990/91;

(c) rates would have gone up anyway if balances were not available. There is no case for covering this change by a safety net, since the safety net is to cover the change from rates to Community Charge not the different financial practices of authorities.

Q. The CBI say the UBR burden is unfair, inflationary and £2 billion higher than it should be.

A. Rates typically represent only about 1-2% of turnover and are a much less important cost than rent. The Confederation of British Industry has argued that in fixing the poundage we should aim to raise the same yield as in 1985/86, when these reforms were first announced.

The reduction of £2 billion in business rates which this would involve would require either substantial reductions in other areas of Government spending (eg the Health Service), or an extra 1.5p on the standard rate of income tax.

The Government's changes are not, as the CBI suggest, inflationary because the aggregate amount which were raised in 1990/91 will be broadly the same in real terms as in 1989/90.

Q. My local authority says it will set a Community Charge well above £278/your illustrative figures.

A. The £278 figure is the level of Community Charge every council in England could levy to provide a standard level of service. The figures for individual authorities, published on 6th November and updated on 11th January, show what would be the level of charge if authorities increased their existing 1989/90 spending levels by 3.8%.

They are not predictions of the actual level of Charge in 1990/91 - that will be set by authorities themselves.

Where the charge is higher than £278 (before allowing for any contribution or receipt from the safety net), that is because the authorities in an area are spending more than the Government thinks necessary to provide a standard level of service. This may be through a conscious choice to provide extra services, or through inefficiency. But it is something which authorities will have to justify to their chargepayers.

Many of the speculative charges quoted by authorities imply spending will increase by 10 or 20%, which cannot be justified. High charges are not the result of the grant settlement; they are not the effect of the change from domestic rates to community charges; on the contrary they will be the consequences of local authorities' own spending decisions.

It has been suggested the average charge might be £340. If the Government were to finance spending at that level but with an average charge of £278 an extra £2.2 billion of grant from national taxation would be needed. Given other competing claims on public expenditure, this is unacceptable.

In any event, it is highly likely that additional money would go to increased spending not to lower the level of charge.

- Q. Why not transfer the whole of education spending to the national Exchequer?
- A. This would cost the equivalent of an extra 10p on the standard rate of income tax and would undermine the traditional local democratic control of education, or if grant to local authorities were reduced correspondingly there would be no effect on Community Charge levels at all.