

SECRET



SUBJECT cc MASTER

File AH
cc. J. Mills
(P.U.)

6 Ca-f.

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

6 April 1990

Dear Roger

THE COMMUNITY CHARGE

The Prime Minister held a meeting yesterday, Thursday 5 April, to discuss the community charge. Those present were the Chancellor of the Exchequer, the Chancellor of the Duchy of Lancaster, your Secretary of State, the Chief Secretary, Treasury, the Minister for Local Government, Sir Robin Butler, Richard Wilson and Andrew Wells (Cabinet Office), and John Mills (Policy Unit).

I would be grateful if you would ensure that this letter is not copied without your authority and is seen only by those with a strict need to know.

The meeting considered your Secretary of State's minute to the Prime Minister of 3 April 1990.

Your Secretary of State said that the Government were currently in the eye of the storm over the introduction of the community charge. It was possible that the storm would now begin to abate, as people came to realise that it was local authorities and not the Government who were responsible for excessive charges. But further action to tackle the worst problems would probably be needed over the next twelve months. The first issue was whether to take any further steps to mitigate the level of community charges in the current year, 1990-91, for instance by increased payments under the transitional relief scheme. The main advantage would be to reduce expectations about the going rate for community charges when authorities made their budgets for 1991-92. But there were also strong arguments the other way, in particular the cost of such action and the fact that it would be portrayed by the Government's opponents as a panic measure. The meeting would want to consider the balance of these arguments.

Looking ahead to 1991-92, the Government faced three main issues. First, whether to make additional provision for Aggregate External Finance (AEF) for local authorities, with the aim of reducing the average community charge. The paper attached to his minute suggested that local authorities might budget for spending as high as £40.3 billion in 1991-92, and that without additional AEF this might result in an average community charge as high as £450. There might be a case for providing sufficient grant to ensure that the average charge was no higher than the

SECRET

b

1990-91 figure of £363. But it would be essential to ensure that any additional grant did not leak into higher spending. The second issue, therefore, was what more could be done to control local authority expenditure. The paper set out a number of options. His preference was for new and wider powers to cap community charges, which would allow more local authorities to be selected, and for more than one year, and could be used either before or during a particularly financial year. He did not however believe that it would be practicable to cap all authorities. Third, he saw a strong argument for addressing the widespread concern about the fairness of the community charge. This would require further work on various options, including enhancements to the transitional relief scheme, improvements to the benefit arrangements, and possibly some move in the direction of a graduated community charge.

In discussion the following main points were made -

- a. Providing further money in 1990-91, for example to finance the area safety net, would impose an unacceptable burden on the Exchequer, particularly in view of the resources which had already been made available. It would also appear to validate the budgets which authorities had set. For these reasons it should not be pursued.
- b. The figures suggested in the paper for local authority spending and average community charges in 1991-92 were a matter for concern. If the Government simply provided more AEF this might leak into yet higher spending. It would therefore be essential to consider what could be done to impose effective control on local authority expenditure before deciding the level of AEF for the coming year.
- c. One reason for the high level of charges forecast for 1991-92 was the transfer of community care responsibilities to local authorities at the beginning of that year. £500 million had been allowed for this, but local authorities might well spend more in practice. There was therefore a case for considering whether to delay the introduction of the new community care arrangements, perhaps for three years. This would also reduce the number of changes which local authorities had to cope with in 1991-92.
- d. More generally, the present framework within which local government operated was wrong. Their powers were too wide, and this led to excessive spending. The Government needed to devise a new framework, with appropriate powers, matched by appropriate controls. One option would be to apply cash limits to local authorities. But that would strike at their constitutional position as independent bodies. With cash limits there would be no real role for independent revenue raising powers, and local authorities might become little more than branch offices of central Government. These were serious disadvantages.

e. A better approach might be to build on the existing powers to cap excessive spenders, and to introduce new financial incentives in favour of moderation. This might involve a new system of expenditure targets for all local authorities, set by formula rather than individually, and graduated on the basis of past performance. For example, authorities spending below their standard spending assessments (SSAs) might be allowed an increase of X per cent; those spending up to, say, 5 or 10 per cent above SSA might be allowed an increase of X - Y per cent; and higher spenders might be allowed an increase of only X - Y - Z per cent. It would be possible to use targets of this sort to cap the community charges of all local authorities. But this would be strongly resented by responsible authorities. It might therefore be better to cap only the most excessive spenders, perhaps 50 in all: this form of capping should apply for more than one year so that expenditure could be progressively reduced. It would also be possible to draw on the expertise on the Audit Commission to help these authorities set their houses in order. For the remaining authorities there would be financial incentives to ensure that they spent at or below target. Various problems would need to be overcome if such a system was to be successful. The quality of SSAs would be important, and it might be necessary to provide a new legal definition to underpin them. There would also need to be rights of appeal against capping. New legislation would be needed. But these problems should not be insuperable.

f. There was also a strong case for one or more minor sources of revenue for local authorities, to act as a safety valve in the new system. Further consideration should be given to the options. One possibility would be to give local authorities discretion to levy a small surcharge on local petrol prices - and perhaps 1 per cent on VAT - in their area and possibly on Vehicle Excise Duty (VED): this should in particular be studied. Another possibility would be to allow them to use a proportion of certain capital receipts to fund revenue spending: this would need to be constrained tightly, for instance to include receipts from the sale of council homes or derelict land but not sale and leaseback arrangements. A case could also be made for a small charge or levy on businesses, who had benefited substantially from the introduction of the Unified Business Rate (UBR). But on balance this would probably be seen as a reversal of Government policy.

g. The case for Government controls on local authority manpower needed to be explored. Such powers were already available in the case of the police and fire services, and extending them might provide an indirect but effective control over the largest single element of local authority spending.

h. There was less to be said in favour of other options explored in the paper. Specific grants would not in themselves reduce expenditure, and might even tend to increase it. Removing services from local authorities would

reduce the community charge only if the Government kept grant at its present level. This would be a substantial new burden on the Exchequer, and there would be a serious risk of leakage into higher spending on other services.

i. There might be a case for more work to improve the fairness of the community charge. The main problem was not those on the lowest incomes, who were benefiting from a substantially more generous system of rebates than had applied to rates. It was the people whose incomes were just above the benefit level, many of them facing sharp increases in their bills. These were the people whom the transitional relief scheme had been designed to help, and more work was needed on the possibilities for enhancing the scheme. This might be a better use of additional money than a general increase in AEF. There might be a case, although it was not so strong, for looking at some aspects of the benefit system, including the income taper and the earnings disregard, although any concession in the latter area should be targeted towards the young. There were also arguments for improving the treatment of capital in the calculation of community charge rebates. But this would be expensive and would have unacceptable knockon effects for other benefits.

k. The meeting was not convinced that there was any case for introducing a graduated community charge. In particular there was no case for penalising people with high earnings, who had just been disadvantaged by the decision not to uprate the upper earnings limit for income tax in the Budget. In any case such action would do little to help the presentation of the community charge to those on lower incomes.

l. There was a strong case for removing the community charge from the calculation of the Retail Prices Index (RPI). It was a direct tax, and should not be in the RPI. But it was clear that the present RPI Advisory Committee were unlikely to change their recommendation on this point. The best way forward might be through international discussions designed to harmonise the calculation of the prices indices of all OECD members.

The Prime Minister, summing up the discussion, said that there was no question of the Government providing more money to reduce community charges in the current year, 1990-91. To do so would put an unacceptable burden on the Exchequer, and appear to validate the excessive budgets which local authorities had set. The figures in the paper for the following year, 1991-92, were a matter for concern. One reason for the forecast increase in charges was the proposed transfer of community care responsibilities to local authorities from 1 April 1991; the Secretary of State for Health should be asked whether it would be right to delay this change. More generally, the Government's objective should be to cut the level of the community charges in many areas by ensuring that local authorities cut their expenditure. It would not be possible to consider what level of AEF should be made available for 1991-92 until Ministers had

identified ways to control local authorities' expenditure and to prevent extra grant leaking into yet higher spending.

The most promising option identified in discussion was to introduce a framework for local authority expenditure which incorporated both community charge capping in a strengthened form, and a new scheme of financial incentives to reward authorities which kept their expenditure down. Targets would be set for all local authorities according to a formula which took account of their past behaviour. Authorities spending below SSA might be allowed the largest year-on-year increases, those spending up to SSA plus, say, 5 or 10 per cent might be allowed a more modest increase, and the highest spending authorities might be expected to live within a lower increase still. The highest spending councils, perhaps 50 in all, would be capped to ensure that they could not exceed their targets. This form of capping could in appropriate cases last for a number of years, so that phased reductions in expenditure could be achieved. The expertise of the Audit Commission would also be used to help these authorities to put their houses in order. The remaining authorities could be subject to a new system of financial incentives, funded out of the agreed total of AEF, to spend at or below their targets. There might also be a good case for allowing local authorities to draw on some additional minor sources of revenue, to relieve some of the pressure on the community charge and act as a safety valve. Consideration should be given to the possibilities, including a small local surcharge on petrol prices or on VED, and the use of a proportion of capital receipts from specific sources such as the sale of council houses and derelict land to fund revenue spending. Further consideration should also be given to the possibility of introducing comprehensive controls on local authority manpower, which would indirectly control the largest single element in their expenditure. But two other options, increased specific grants and taking services away from local authorities, did not seem promising and should not be pursued.

There was also a case for action to improve the fairness of the community charge. The worst affected group were those in the middle, with incomes just too high to qualify for rebates. The transitional relief scheme had been designed to help them. Further consideration should be given to enhancing the scheme, for example by phasing it out more slowly. The case for improvements to community charge rebates was less strong, although further work might be justified on the possibility of changes in the income taper and in the earnings disregard, particularly for younger people, but without any extension to housing benefit. The possibility of introducing a graduated community charge should not be pursued.

Your Secretary of State should put in hand further work on these issues and circulate a new paper to the group in time for a meeting to be held in the week commencing 23 April. The Chancellor of the Exchequer would arrange for work to be put in hand on a separate paper for the same meeting on the possibility of a small local surcharge on petrol or VED.

f

There was also a case for work on a longer timescale on the fundamental causes of excessive expenditure by local authorities. There was a strong case for arguing that the present framework of local authority powers and responsibilities was flawed. Their powers were too wide, and the Government's powers to influence their aggregate expenditure too restricted. Work would be needed to devise a new framework, with appropriate powers for both local and central Government. Other ideas, including the possibility of unitary authorities and of annual local authority elections, would also need to be considered. Your Secretary of State would wish to consider how this should be carried forward in due course.

I am copying this letter to the Private Secretaries to the Ministers who attended and to the others present.

Yours ever,

Barry

BARRY H. POTTER

Roger Bright, Esq.,
Department of the Environment