



RESTRICTED

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The Rt Hon John Major MP
Chancellor of the Exchequer
HM Treasury
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Prime Minister
Mr Patten is not
challenging the proposal
to take capping into account.
The final amble is the RPIAC
tomorrow.

My ref:
Your ref:

3 April 1990

Dear Chancellor

BHP 115.

mb

Thank you for letting me know of your proposed treatment of community charges in the Retail Price Index which involves building into the index from April estimates of the charges as they would be after I have finally determined the level of the caps. I understand that this matter is going to be put to the Retail Price Index Advisory Committee on Wednesday and I believe it is important that two key matters be brought to the Committee's attention.

Firstly, they should know that the authorities which I have designated for capping have 28 days under section 102(5)(a) of the Local Government Finance Act 1988 in which to challenge the level of cap which I have proposed. Where authorities make such challenges - nearly all have already done so - I have a discretion regarding the representations which I shall be receiving and I may, if I consider that it is appropriate on the basis of the evidence available to me, propose a higher level for the cap which I have so far proposed.

Secondly, the Committee should also know that most authorities designated for capping are making challenges through the courts regarding the capping decisions which I have already taken. The indications are that 20 of the 21 authorities will be making such challenges.

If the Committee requires further information I shall of course be happy to give it.

You will appreciate that, whatever statistical estimates of the outcome are made I have to keep an open mind in regard to the representations I shall be receiving. And should it be suggested in any legal proceedings that I failed to approach my decisions correctly, because of the methodology adopted in the Retail Price Index, I shall need to make my position clear. I would propose to do so by referring to this letter.

I am copying this letter to the Prime Minister.

Yours sincerely

Chris Patten
Private Secretary

CHRIS PATTEN

*Approved by the Secretary of State
but signed in his absence*

Local Govt: Rate A 12

M. P. M. 38 (a-h)

C-1 ECONOMY Submitted
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2/1/90DRAFT LETTER FOR BARRY POTTER TO SEND TO PHILIP WARD, PRIVATE
SECRETARY, SECRETARY OF STATE FOR THE ENVIRONMENT

THE COMMUNITY CHARGE

The Prime Minister had a meeting at 11 am on Thursday 26 April to discuss the community charge. Those present were the Lord President of the Council, the Chancellor of the Exchequer, the Secretary of State for Wales, the Chancellor of the Duchy of Lancaster, the Secretary of State for Scotland, your Secretary of State, the Chief Secretary, Treasury, the Chief Whip, the Minister for Local Government, Sir Robin Butler, Richard Wilson, Muir Russell and Andrew Wells (Cabinet Office), Sir Terry Heiser and Christopher Brearley (DOE) 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 minutes to the Prime Minister from your Secretary of State dated 23 April 1990, the Chancellor of the Exchequer dated 24 April 1990 and the Secretary of State for Scotland dated 25 April 1990.

Your Secretary of State said that the Government had been wrestling with the problem of local Government finance for 11 years. The new community charge regime had been introduced because other measures of control had failed. His minute listed some of the more radical options available. Some of these had been tried or considered in the past, and were clearly not serious runners. If the long-term objective was to control local authority spending, then in his view the logical conclusion was a radical limitation of authorities' power to raise local taxes, apart perhaps from a small residual tax as a safety valve. This option was worthy of further consideration, but was not an immediate solution. For 1991/92 the Government faced three main questions: the level of community charge which was acceptable and the implications of that for Aggregate External Finance (AEF); what new controls were necessary

[Barry:
n.b.
Mark
Lennox -
Boyd not
mentioned.]

to ensure that any extra AEF was used to abate charges and did not leak into higher expenditure; and what changes needed to be made to the community charge regime to increase its fairness.

On the first question, his view was that the Government needed to be in a position to say with credibility that responsible authorities would be able to set community charges in 1991/92 no higher than in 1990/91, and in many cases should be able to make reductions. To achieve this it would be necessary to get the right balance between AEF and the control of expenditure, which would need to bite on all services, including those for which other colleagues were responsible. He fully recognised the problems of the forthcoming public expenditure round, and the likely sensitivity of the financial markets. But he had to stress that a satisfactory political outcome was unlikely to be achievable with a substantial increase in AEF.

As far as the control of expenditure was concerned, he proposed to take enhanced powers for exemplary capping of the highest spending authorities. Such powers might in due course catch about 50 authorities, who would be subject to capping over a run of years ("multi-year capping"), and therefore be obliged to reduce their spending much closer to their standard spending assessments (SSAs). Such powers would raise political, legal and administrative problems, but he believed that these could be overcome. He had also considered whether there should be a system of targets for all local authorities, backed by financial incentives for those who achieved them. But he had concluded that any such system would be excessively complex, and difficult to explain and justify. It would look very much like the discredited system of targets and holdback operated in the 1980s. He had therefore rejected it.

It was also necessary for the Government to take action on the perceived unfairness of the community charge. He proposed a package of measures. First, a supplementary charge for all those with incomes high enough to pay higher rate income tax. He suggested that all such taxpayers should pay a supplement of half the average national community charge, that those with incomes

above about £50,000 should pay a supplement of a full average charge, and that those with taxable incomes above about £100,000 should pay two charges. Second, he proposed to extend the life of the transitional relief scheme from 3 years to 5, with no withdrawal of relief until 1993/4, and extended relief in areas where the safety net and low rateable value grant were being phased out. Third, he proposed changes to community charge benefits, to increase the earnings disregards and to make the treatment of savings more generous. Fourth, he proposed a revision of the rules for the standard community charge, in particular to give relief to those who were forced by circumstances to maintain a second home.

He believed that these proposals represented a sensible package of measures, which should be announced together when he made his settlement statement in July. Some would need only secondary legislation. His proposals for higher rate taxpayers would need primary legislation, but this could be included in the 1991 Finance Bill. His proposals on capping were therefore the only ones which would require a new Bill. It would be important to get the legislation right, and he therefore favoured introducing this legislation at the start of the 1990/91 Session, rather than in the present Session, provided Royal Assent could be achieved before the start of the new financial year.

In discussion the following main points were made -

- a. Decisions on the community charge needed to be taken in the light of the wider economic situation. It was already clear that the Government were facing a very difficult public expenditure round in the current year, and there was no money to put into extra AEF. The Financial Statement and Budget Report allowed for an increase in local Government expenditure of about 5% in 1991/92 compared to 1990/91. If, as had been suggested, the increase in expenditure was actually 10%, this would add more than an additional £2 billion to General Government Expenditure (GGE), which would need to be financed from higher community charges, higher taxation or Government borrowing. If, for example, the aim was to ensure no increase

in average community charges compared to 1990/91, AEF would need to rise by nearly £5 billion, compared to the £1 billion which was available. Such a situation would clearly be intolerable. The paramount need was therefore for the Government to find effective measures to control local authority expenditure, before any decisions could be taken on AEF.

b. The enhanced capping scheme proposed by the Secretary of State for the Environment was not expected to secure savings of more than £1 billion. This would not be a sufficient response to the problem. In particular, there was a need to control the spending of shire county councils in 1991/92: they faced no immediate elections, and there was a serious risk that, without constraint, they would pass down unacceptable precepts to the district, who did face elections. There was therefore a strong case for extended capping arrangements which would apply to all major authorities, including the shire counties, the metropolitan districts and the London boroughs. It was however important to be realistic about what was achievable by way of cuts in expenditure in any one year, without unacceptable implications for local authority services. It might well be necessary to operate controls for a run of years before substantial expenditure reductions could be secured.

c. On the other hand, there were strong arguments against taking comprehensive powers of this sort, which would undermine the principle of the community charge regime. The new system was in its first year in England and Wales, and it was not surprising that authorities had used this opportunity to increase their budgets. But the evidence from Scotland, where the charge was in its second year, was that increased accountability had resulted in a lower increase in spending there. If the Government did take new powers to control all or most local government spending, they were likely to be blamed for every cut in staffing or services in sensitive areas such as education and personal social services. A

better approach might be to rely on accountability, backed perhaps by new inducements for authorities to moderate their spending, to cut community charges from the very high starting point set in 1990/91.

d. The views of the Government's supporters in Parliament needed to be considered. Initial soundings suggested that ~~they~~^{many} would not react favourably to proposals for widespread capping. But this was because they believed that substantial sums of money could be made available through AEF to reduce the level of community charges in 1991/92. They did not yet appreciate the very difficult public expenditure position facing the Government. When they did, they too were likely to come to the conclusion that a substantial extension of capping, at least on a temporary and transitional basis, was the only option which was likely to deliver an acceptable outcome.

e. One of the factors which might exacerbate an already difficult position in 1991/92 was the prospect of substantial extra burdens being placed on local authorities under legislation in the 1989/90 and 1990/91 Sessions of Parliament. Ministers were already reviewing the community care proposals, to see whether there was a case for deferring their introduction. A similar review was needed in other areas, for example in relation to initiatives on food safety.

f. There was a case ~~on fairness grounds~~ for a limited scheme of supplements for people on the highest incomes, perhaps above about £50,000. But it would be wrong to extend this to all higher rate taxpayers. Those with incomes just above the threshold had in many cases been hit hard by the increase in mortgage rates. Unlike the other tax allowances, the higher rate threshold had not been increased in the Budget. This decision had raised an additional £300 million from higher rate taxpayers, and the Government could take credit for this in presenting any new community charge package. More generally, it would be important to avoid any scheme which

appeared to accept the case for a banded community charge, an option which had been resisted with some difficulty during the passage of the legislation.

g. There was also a case for action of the sort proposed by the Secretary of State for the Environment to maintain the benefits of the transitional relief scheme over the next two years, and then to phase it out more slowly. It would also be right to extend its benefits to people who lost from the withdrawal of the area safety net and the low rateable value grant. But there was also a case for some additional targeted help under the scheme for particular groups of people, for example the disabled and perhaps young first-time community charge payers. Arguments could also be put forward for some relief for non-working wives, ^{but} there were strong counter-arguments. In particular, this would challenge the main principle of the community charge as a flat rate payment, would lead to anomalies as between couples with the same income depending whether one or both partners were working, and would suggest that the Government believed that in this respect a husband could not be expected to support his wife.

h. As far as new legislation was concerned, it would be better if possible to legislate early in the next Session of Parliament rather than in the present Session, which was already subject to difficult time pressures. It might ^{even} prove possible to take special measures to start the new session earlier than usual.

The Prime Minister, summing up the discussion, said that it was essential to get to grips with the fundamental problem facing the Government. If local authorities increased their expenditure by 10% in 1991/92, as had been suggested, this could result in an average community charge of £450 on present plans for AEF. Such an outcome would be totally unacceptable. But there was no question of simply providing additional Exchequer grant to finance the forecast level of expenditure. The Government were already facing a very difficult public expenditure round, and any increase in AEF

which was the need to control local authority expenditure.

would need to be financed by offsetting savings elsewhere in the Planning Total. Against this background it was essential to identify effective measures to control local authority expenditure. Only then would it be possible to consider what level of AEF should be made available.

The question was not whether ^{big} it would be appropriate to control expenditure, but how it could ^{most promising} be done. The ~~best~~ option appeared to be an extension of community charge capping to all major local authorities, including at least the shire counties, the metropolitan districts and the London boroughs. This would require legislation, preferably early in the next Session of Parliament. Further work should concentrate on this option. There might also be a role for the Audit Commission to go into those authorities with the highest overspending, and help them to put their houses in order. This should be considered further.

There was also a case for action to improve the ^{perceived} fairness of the community charge. The meeting had agreed that it would be appropriate to impose a limited supplement, perhaps equal to a single average community charge, on people with the highest incomes, perhaps over about £50,000. But it would not be right to extend such a supplement to all higher rate taxpayers, for the reasons set out in the discussion. There was also a case for some limited action to alleviate the effects of the community charge on those with incomes just too high to qualify for rebates. Measures which could be implemented without primary legislation were to be preferred. The transitional relief scheme was the best instrument for this purpose. The meeting had agreed that it would be right to extend the benefits of the scheme on the broad lines proposed by the Secretary of State for the Environment. But there might also be a case for some additional targeted help for particular groups, for example the disabled and perhaps young first-time payers. Such help should not however extend to non-working wives, for the reasons set out in the discussion. Further consideration should be given to these issues.

The further work which was needed should be carried out urgently by a group of officials under Cabinet Office chairmanship, reporting to a small group of Ministers chaired by the Chancellor of the Exchequer, with the Secretary of State for the Environment, the Chief Secretary, Treasury and the Minister for Local Government as members. A further meeting of the present group would ^{then} be needed ~~in~~ ~~due course~~ to consider the outcome.

There was also a case for a review of legislation in the 1989/90 and 1990/91 Sessions of Parliament which would impose additional burdens on local authorities. Such a review was already in hand in relation to community care. The Secretary of State for the Environment should put in hand urgently a review of other burdens, and report the outcome to the group as soon as possible.

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