THIS DOCUMENT IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT

E(LF)(85) 1st Meeting

COPY NO 29

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

SUB-COMMITTEE ON LOCAL GOVERNMENT FINANCE

MINUTES of a Meeting held at
10 Downing Street on
MONDAY 20 MAY 1985 at 10.00 am

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

The Rt Hon Viscount Whitelaw
Lord President of the Council

The Rt Hon Leon Brittan QC MP
Secretary of State for the Home Department

The Rt Hon Sir Keith Joseph MP
Secretary of State for Education and Science

The Rt Hon George Younger MP
Secretary of State for Scotland

The Rt Hon Nicholas Edwards MP
Secretary of State for Wales

The Rt Hon Patrick Jenkin MP
Secretary of State for the Environment

The Rt Hon Norman Fowler MP
Secretary of State for Social Services

The Rt Hon Norman Tebbit MP
Secretary of State for Trade and Industry

The Rt Hon Peter Rees QC MP
Chief Secretary, Treasury

The Rt Hon Nicholas Ridley MP
Secretary of State for Transport

The Rt Hon Earl of Gowrie
Chancellor of the Duchy of Lancaster

The Rt Hon Kenneth Baker MP
Minister for Local Government
Department of the Environment

THE FOLLOWING WERE ALSO PRESENT

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer

The Rt Hon John Wakeham MP
Parliamentary Secretary, Treasury

Mr Michael Ancram MP
Parliamentary Under-Secretary of State, Scottish Office

The Rt Hon Lord Young of Graffham
Minister without Portfolio

Mr John Gummer MP
Paymaster General

The Hon William Waldegrave MP
Parliamentary Under-Secretary of State, Department of the Environment

SECRETARIAT

Sir Robert Armstrong
Mr C J S Brearley
Mr J E Roberts

SUBJECT

LOCAL GOVERNMENT FINANCE STUDIES

LOCAL GOVERNMENT FINANCE STUDIES

The Sub-Committee considered a Memorandum by the Secretary of State for the Environment (E(LF)(85) 1) covering an Introductory Report and a Specification Report describing the preliminary results of the Local Government Finance Studies. The Sub-Committee also considered Memoranda by the Chancellor of the Exchequer (E(LF)(85) 3) and the Secretary of State for Education and Science (E(LF)(85) 2) commenting on the proposals set out in those studies.

The Sub-Committee -

1. Invited the Secretary of State for the Environment to develop further, in consultation with other colleagues as appropriate, the proposals set out in the reports attached to E(LF)(85) 1, taking account of the points made in discussion and in the summing up, and to report to the Sub-Committee in September.

2. Invited the Chancellor of the Exchequer to circulate details of a possible modified property tax.

Cabinet Office

22 May 1985

Index .... CAB 134/4879

SUBJECT

MOST CONFIDENTIAL RECORD

No.	Contents	Date
	E(LF) 1st Meeting Monday 20 May 1985 LOCAL GOVERNMENT FINANCE STUDIES	

(8713) Wt. 24871/6103 1m. 6/64 P.I. Gp. 610

Copy No 1 of 5 Copies

MOST CONFIDENTIAL RECORD
TO
E(LF) 1st Meeting

Monday 20 May 1985

LOCAL GOVERNMENT FINANCE STUDIES

The Sub-Committee considered a memorandum by the Secretary of State for the Environment (E(LF)(85) 1) covering an Introductory Report and a Specification Report describing the preliminary results of the Local Government Finance Studies. The Sub-Committee also considered memoranda by the Chancellor of the Exchequer (E(LF)(85) 3) and the Secretary of State for Education and Science (E(LF)(85) 2) commenting on the proposals set out in those studies.

THE SECRETARY OF STATE FOR THE ENVIRONMENT said that it had been agreed in earlier discussion that the Government's existing policies on local government finance could not continue indefinitely as they were. As time went on, present mechanisms were less effective in restraining local authority spending, but increasingly difficult to operate and widely unpopular. The studies had therefore been exploring new arrangements. There were essentially two approaches. The Government could take more direct control over local government finance, but such a "centralist" approach had many disadvantages. The alternative was to introduce a greater degree of local accountability to the electorate, and to rely on this mechanism to restrain local government expenditure. The latter approach was more compatible with Conservative policy, and the proposals set out in the Reports were therefore based on it. He was not seeking final agreement to detailed proposals at this stage; further work was needed to develop the proposals and to assess the full implications for different authorities and classes of individuals. Modifications would be needed to achieve fair and acceptable results but he hoped that the Sub-Committee would endorse the general approach and authorise further work.

THE MINISTER FOR LOCAL GOVERNMENT, describing the background to the proposals, explained that total local authority income in England was about £40 billion a year; of this 44 per cent came from Government grants, 16 per cent from borrowing or capital receipts, 17 per cent from non-domestic ratepayers, 11 per cent from domestic ratepayers, and the balance from other receipts. Existing policies to restrain expenditure depended primarily on controlling the amount of Exchequer grant which authorities received. Under present arrangements 10 authorities already received no Exchequer grant, and this number would rise to about 20 the following year. Once an authority received no grant, the Government had no influence over its spending except through rate limitation which carried its own difficulties and risks, including increasingly that of judicial review. Adequate local accountability was lacking because of the disparity between voting and the payment of rates. On average 60 per cent of rate income came from non-domestic ratepayers; in some authorities this figure was as high as 75 per cent. Of the 35 million adults in England, only 18 million were domestic ratepayers and at present only 12 million of these paid rates in full. There were a number of other problems also. First, rates gave confusing signals to electors because there was no direct relationship between changes in expenditure and changes in rates. Secondly, because of the way in which the Exchequer grant was distributed between authorities and the differences in rateable values around the country, ratepayers paid significantly more for the same level of service in some areas than in others. Thirdly, the incidence of rates between households bore very little relationship to the use of services. New arrangements based on greater local accountability would necessarily be painful, because it would be necessary to make the consequences of excessive local government spending more perceptible to electors and for more people to bear part of the burden. There should be four basic principles:

1. the full impact of any increases in expenditure by a local authority should fall on the local electors, and conversely they should benefit from any reduction;

2. there should continue to be special help to compensate for differences in need;

3. the same levels of service should cost the same in different parts of the country;

4. there should be a system for distributing the Exchequer grant which was more straightforward and automatic in its operation than the present system.

THE PARLIAMENTARY UNDER SECRETARY OF STATE, DEPARTMENT OF THE ENVIRONMENT (MR WALDEGRAVE) explained the main proposals:

1. The non-domestic rate would be levied at a single national level and its yield would be pooled and redistributed to local authorities in proportion to their population. This proposal would protect businesses from very high levels of rates and from large and unpredictable annual increases. Some businesses, in low spending areas, would, however, face an increased burden, and local authorities were unlikely to welcome the proposal because it would introduce greater centralisation. It would be necessary to phase in any change, and to link it with a revaluation of non-domestic rateable values. If it were thought that the redistributive effects would be too severe, alternatives would be to freeze non-domestic rates at their present levels and place a cap on future increases, or to set a national maximum rate; but these would all continue existing inequities.

2. The existing Exchequer grant would be replaced by a new lump sum needs grant. The existing allocation mechanism aimed to compensate for differences in both local resources and needs, and also took account of authorities' spending levels. If the non-domestic rate were set nationally and the yield pooled as he had proposed, and if domestic rates

were reformed on the lines he would be suggesting, there would be no need for equalisation to reflect differences in rateable values. It would, however, still be necessary to take account of differences in need, and the aim should be that local taxpayers should pay the same for equivalent standards of service throughout the country. This could be achieved by a fixed lump sum grant consisting of a needs element and above that a standard sum per head set nationally. The grant would not vary according to actual spending levels, and so would be simpler to operate and would ensure that the whole of the cost of any additional expenditure fell on the local taxpayers. They would benefit similarly from lower expenditure.

3. Domestic rates should be replaced by a residents' charge set annually by each local authority and levied on all adult residents. This tax would be perceptible, non-buoyant, and fairer because its incidence would be more closely related to the consumption of services. Registers of residents would need to be established, and there might be objections to this on civil liberties grounds; in fact, however, any local tax based on people (including local income tax) would be open to the same objection.

The effect of these main proposals would be to increase local accountability sharply. For example, on reasonable assumptions about how the system would work, a 10 per cent increase in expenditure by a typical council would be likely to lead to an increase of 30 per cent or more in the residents' charge. Conversely a 10 per cent reduction in spending would be likely to result in a 30 per cent or more reduction. The changes were radical, and there would in consequence be significant changes in levels of local taxation for different areas and different types of household. Those living in high spending areas or where rateable values were low would face higher local taxes; but this was in accord with the principles underlying the proposals. The precise details were sensitive to the way in which the Exchequer grant would be distributed, and to how authorities responded to the increased pressure to reduce their spending. There would, however, be a small number of authorities where an unacceptably high residents' charge might result: special arrangements would be necessary for inner city areas and for London in particular. Transitional arrangements would also be necessary. In terms of households, those containing only a single adult or living in high rateable value property would be better off, while those with three or more adults or living in low rateable value properties would be worse off. For most households, however, the residents' charge might be no more regressive than rates. In all up to 9.25 million households might be better off and 7.45 million worse off, of which 60 per cent would face a change of less than £2 a week; but 1.05 million households would lose more than £5 per week. This represented an extreme outcome; in practice there would be a number of mechanisms to modify these effects, including improvements to the assessment of spending needs, possibly special grants for inner city areas and special arrangements for London, more generous rebates, and perhaps graduations in the residents' charge. Other possibilities were to continue, although at a reduced level, some form of domestic rating or to rely on increased Exchequer grant or other local taxes in addition to a residents' charge.

The other elements of the package included: better controls over capital expenditure, greater reliance on fees and charges for local services, annual elections to increase accountability, and better rules covering the formulation of local authority budgets. Each of these would contribute to making the proposed system more effective.

In summary, the objective was to find a new system of local government finance which struck a balance between on the one hand Central Government's desire to encourage local authorities to operate more economically and effectively and to constrain the burden they imposed on local taxpayers, and on the other the need to restore proper local accountability and avoid detailed Central Government involvement in their affairs. The system suggested provided the best chance of a durable self-regulating system from which Central Government could stand back.

In discussion the following points were made -

a. There was general agreement that the existing system of local government finance was near the point of breakdown, and that a fundamental change was necessary. The system was unfair and unreasonable, and the Government could not enter the next Election without being seen to deal with the problem.

b. The fundamental assumption underlying the package of proposals set out in E(LF)(85) 1 was that in return for increased accountability to their electorates local authorities could be given greater freedom to determine their levels of expenditure. The danger was that the proposals would not be sufficiently effective and that the Government would not have adequate influence over an important component of public expenditure. It was a proper function of Central Government to set limits to public expenditure and to the burden imposed by taxation, wherever raised. While there was strong support for the principles on which the package was based, it might be necessary to consider whether more direct methods of limitation were also necessary. There could be no question of allowing local authority expenditure to rise on account of the changes proposed.

c. While there were strong arguments for rejecting a highly centralised approach, it should be remembered that the Government already had a significant degree of control over local authorities through setting limits on capital expenditure, through specific grants and in other ways.

There might be merit in strengthening the role of specific grants, particularly in the education field. The possibility of Central Government taking over the financing, though not the management, of some or all of the education service should also be considered. The latter course would, however, carry a significant risk of Central Government becoming involved to a far greater extent than was desirable in the detailed running of the service; and, unless Central Government expenditure was increased, it would not affect the amount of local expenditure falling to be met by local taxpayers.

d. The proposals to limit the extent to which local authorities could raise money from non-domestic ratepayers were strongly supported. There was a risk that a future Government might exploit industry and commerce by setting a high national rate, but this was not a sufficient reason to hold back from the proposed reform. While the proposed system of establishing a national non-domestic rate had attractions, alternatives such as setting a national limit but leaving authorities free to rate within that limit and to retain the proceeds should not be ruled out. Further work would be needed on appropriate mechanisms for setting the national rate, and a revaluation would be necessary. This might take effect in 1989-90, and be announced in the autumn.

e. The present system of grant distribution favoured areas with low rateable values (particularly the North of England) at the expense of areas with high rateable values. Once the implications of removing this cross subsidy became clear there might well be considerable opposition from the areas that would lose. Opponents of reform might also draw attention to the fact that better-off people would benefit at the expense of those in middle income bands. While the evidence suggested that the package as a whole might not be as regressive as had been feared, considerable further work would be necessary to identify in more detail the numbers of gainers and losers and the extent of the sums involved.

f. While there were considerable attractions in the simplicity and fairness of a residents' charge, the impact might turn out to be too regressive. It might be possible to introduce a graduated charge in order to help the lower paid, but this would move the system closer to local income tax with all the difficulties which that involved. A local sales tax might be a useful adjunct to ease the burden on a residents' charge, although since this would produce a buoyant yield some form of limit would be needed to check increases in expenditure. Alternatively some form of modified property tax might be retained, though the absence of an adequate rental market made any domestic revaluation on the present basis inconceivable, and capital valuation would be little better, so that there would be considerable difficulties in continuing with an element of domestic rates. Another alternative was a local supplementary vehicle excise duty.

g. It would be a considerable task to compile a residents' register, and there would be a strong incentive to avoid registration. A requirement to produce proof of registration before local services such as education could be used would provide a check, but the implications would need to be considered further.

THE PRIME MINISTER, summing up the discussion, said that the Sub-Committee was extremely grateful to the Secretary of State for the Environment and his colleagues for the Reports they had prepared. They fully accepted that the existing system of local government finance was in urgent need of reform. There was general agreement that reform should be in the direction of a simpler system, requiring less Government intervention, although Central Government could not abdicate responsibility for the aggregate of public expenditure and for taxation. The Sub-Committee would not be able to reach final decisions until further information was available on the redistributional effects which the package set out in E(LF)(85) 1 would have on authorities and individuals in different circumstances, and the Secretary of State should put this work in hand. Subject to that, the Sub-Committee supported in principle the proposal to limit the extent to which local authorities could raise taxes from non-domestic ratepayers. While they saw the attractions of setting a national non-domestic rate and pooling the yield, they would not rule out alternatives which would not result in increased costs to businesses in low spending areas, including the possibility of capping non-domestic rates or limiting the amount by which they might be increased. The Sub-Committee recognised the attractions of replacing the present system of Exchequer grant by a simpler system based on a lump sum grant, and of replacing domestic rates by a residents' charge. These proposals would, however, entail a considerable redistribution of resources and burdens, and the Sub-Committee would need to look closely at the implications. Further work should be done on modifications which would be required to eliminate the more extreme consequences, particularly in London, inner city areas and other areas of high need, and on transitional arrangements. The arrangements for collecting a residents' charge would also need to be studied and discussed in greater detail, to see whether and how some of the problems foreseen could be overcome. Further work should be done on various possible alternatives for reducing the amount which needed to be raised by means of a residents' charge: for instance, on the possibilities of making greater use of specific grants to support local expenditure, especially where (as in the educational field) there might be other policy reasons for doing so, or even of transferring the whole of the cost of the education service to the Exchequer, or of retaining some form of modified property tax, or of introducing a local sales tax, or other source of finance, perhaps from the proceeds of national taxation (eg part of the proceeds of value added tax). The Chancellor of the Exchequer would circulate a memorandum on how a modified property tax might be established; this would need to cover the methods for revaluing domestic property as a basis for assessment to liability for such a tax. Whatever reforms were introduced should not result in an increase in public expenditure. The Secretary of State for the Environment should develop his proposals further, and report to the Sub-Committee again in September with a view to the Government taking decisions before the end of the year. The Sub-Committee would also wish to consider in more detail in September the other proposals, relating to capital controls, fees and charges, annnual elections and the regime for local authority budgeting.

The Sub-Committee -

1. Invited the Secretary of State for the Environment to develop further, in consultation with other colleagues as appropriate, the proposals set out in the Reports attached to E(LF)(85) 1, taking account of the points indicated in discussion and in the summing up, and to report to the Sub-Committee in September.

2. Invited the Chancellor of the Exchequer to circulate details of a possible modified property tax.

Cabinet Office

22 May 1985