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CABINET

MINISTERIAL STEERING COMMITTEE ON ECONOMIC STRATEGY
SUB-COMMITTEE ON LOCAL AUTHORITY FINANCE

SECOND SPECIFICATION REPORT

Memorandum by the Secretary of State for the Environment

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1. At our meeting in May I explained why, if we are to continue to restrain local government spending, the present local government finance policies have a limited life. The political price, even among our supporters, of intervention through the top-down pressures of rate support grant is heavy and the scope for significant further grant cuts is limited. Too many authorities go out of grant; rate capping is pitching us into direct confrontation with extremist inner city authorities; there is a constant risk that a major legal defeat will undermine the statutes. There have already been seven legal challenges - two of which, fortunately not crucial, we lost - in 1985/86 and we know of four more in the offing. Finally, there are signs that fewer and fewer people of quality and integrity are ready to come forward as elected members, and to serve as senior local government officers. The combination of all these factors jeopardises a number of our mainstream domestic policies because we rely on the positive co-operation of local government for their effective implementation.

2. I outlined in May a first sketch of arrangements which would deal with these problems and at the same time reform the domestic rating system. The attached Second Specification Report, presented jointly by William Waldegrave and myself, fills in that sketch. In the light of colleagues' comments in May and further work, it puts forward a revised specification. The paragraph references in this memorandum are to that Report.

Political considerations

3. The reform of local government finance is essentially a constitutional and political question. Local authorities have considerable powers enshrined in a series of statutes; pride in their independence; and an almost unstoppable capacity to spend other people's money. The central question is how to make them more responsible.

4. One option would be increased central control. But this would mean more central bureaucracy, less local choice, and a diminution of pluralism which we have always supported. It would be a gift to any incoming government with objectives opposed to our own which wished to force through policies in areas currently the responsibility of local authorities.

5. Our answer is to make local authorities more accountable to a local electorate with a direct financial stake in their actions. More people - in our proposals 35 million instead of 15 million at present, and 18m after implementation of the Social Security review proposals - should exert a genuine pressure through the ballot box. This is a bottom up pressure and it enhances democracy. We cannot, of course, relinquish our interest in the overall level of local government expenditure and the general burden on taxpayers. It is therefore very encouraging to be able to report that the disincentive to increase expenditure (and the corresponding incentives to make reductions) under our proposed new system should be significantly <u>greater</u> than under the present arrangements. I hope and expect that the proposed financial changes designed to enhance local accountability and democracy will be reinforced by the legislative outcome of the interim Widdicombe Report on party political propoganda and, when received, the final Widdicombe Report on the internal processes of local government. As a quid pro quo <u>central government must be prepared to reduce its detailed intervention in local authority decisions</u>. You can't have one without the other.

6. The alternative to our approach is yet more top-down pressure through greater central control. This at a time when councils are becoming more strident in their demands for local independence; more effective in evading the existing controls; and more adroit in passing all the odium for everything that goes wrong on to the Government. Prolonged trench warfare between central and local government is an appalling prospect which would sap the political and psychological energies of Government. There are better things to do.

7. Electoral considerations also point to change. The rates issue will be a central one at the next election. We can't go into that just promising reform. We have to set out quite specifically the detail of the new system, how it will work and how it will affect people. A major change already decided on for 1987 will be the payment of at least 20% of the rates by all 18m householders.

8. We must however ensure that our proposals are going to be more popular than the alternatives. This will turn on how far we can show the proposed system to be intrinsically fairer than the present system and reduce the number of losers to politically manageable proportions. There is little point in embarking on the reform of rates if it is going to cost us votes. We start with the advantage that rates are not popular. In some areas they are now very high and, if present trends continue, many householders in these areas will be paying more in rates than they do in income tax. Rates bear little obvious relationship to use made of local authority services. The rate base is too narrow

and out of date, but revaluation with rates raising the same amount of revenue as now could have politically devastating results.

9. We must identify and explain the unfairness of rates as between different households and different parts of the country. We must show that local democracy cannot function with a gross imbalance between the few who pay local taxes and the many who enjoy local services. We want a new and better system based on the principle "trust the people". Under our proposals all adults will pay something, so the burden will be carried on more shoulders. Nonetheless overall more households will gain than lose.

10. Labour is likely to stick by the present rating system because it collects a lot painlessly from business and because fewer people pay into the pool than draw from it. They could go for rates bolstered by some form of local income tax. The Liberals and the SDP are likely to go for a local income tax since this increases local tax payers to 21 million and it reflects ability to pay. They overlook the general unpopularity of increasing income tax and the deterioration of the work incentive it entails; the reluctance of people to see sensitive information divulged to Town Hall staff; and the sheer administrative complexity of operating LIT. We must ensure that the drawbacks of LIT are well understood by the wider public.

11. We must not, now, recoil from reform. To reform rates and, in doing so, create a new system which allows central government to draw back from interference in too many local decisions is a considerable political prize. We cannot afford another five years of running battles with local government and its supporters - in Parliament and the Courts - with no prospect in sight of a better system at the end of it. We cannot ignore the pressure to reform an unfair and unpopular tax. We cannot enter the next election at war with our own party in local government; and we must be able to confront our opponents with a viable package of changes, to fight on our ground not theirs. That is the background against which we present our revised proposals.

<u>Revised proposals and their effects</u>

12. The First Specification Report last May proposed:

- a uniform national non-domestic rate;
- a simplified needs grant supplemented by a per capita standard grant;
- a flat-rate residents' charge as a direct replacement for rates.

It also noted that a city grant and special London arrangements could be needed to produce acceptable results in the major urban areas. We have made certain modifications to our original proposals in the light of our further work.

13. On the non-domestic rate we propose a small operational amendment to our May proposals. We would give local authorities discretion to set a local non-domestic rate of up to 5 per cent of the national non-domestic rate. The new national rate would be set 5 per cent lower to reflect this. This will retain the link between business and local authority. The CBI have argued strongly that the main legislation giving effect to this proposal should provide for a maximum rate of increase. We propose that increases should be indexed to our annual GDP deflator forecast. Colleagues will want to consider whether we should soften the transition to the uniform rate by a marginal reduction in the overall yield of the non-domestic rate (paragraphs 4.2 - 4.4).

14. On grant, our proposals are unchanged in terms of the operation of the system. Much work will of course need to be done on the new needs assessment system. But we have concluded that the greater pressure on local authorities' expenditure which our proposals will provide open up the possibility of further disentangling central Government from the affairs of local government without weakening the new disincentives to extravagance. We propose therefore that the standard grant be calculated as a guaranteed local share of a national tax - an assigned revenue. The most promising candidate appears to be VAT. On current figures, replacing standard grant would mean assigning a quarter of the present VAT yield to local government.

15. The attraction of this is that it would enable central Government to get out of the game of tinkering with the grant arrangements every year, while making it much more difficult for local authorities to blame central Government for increases in their local tax bills. Consistent with the whole thrust of our package, it would be clear to voters that increases in their local tax bills were the responsibility of the authority and not a result of central government's adjusting the amount of standard grant. In addition, an assigned revenue will bring home to local taxpayers that it is they - in their role of national taxpayers - who are paying for the revenue support their authority gets from central government. In terms of presenting the package to local government, the greater revenue stability from a guaranteed share of a national tax will be welcomed by the prudent authorities who are our supporters, and will do much to counter the likely opposition to the centralisation of the non-domestic rate (paragraphs 4.13 - 4.16)

16. It is on the residents' charge that we propose the only major change. At the last meeting of E(LF) we were asked to see whether a residents' charge as a direct replacement for domestic rates could be modified to iron out some of the sharp effects which such a change would entail. We have considered various modifications. We conclude that the best approach would be to retain some small element of property taxation alongside the residents' charge. This should help to moderate extreme changes in local tax bills when we move to the new system, and it has other advantages. Some local authority services clearly benefit property rather than people. The retention of a property element, with some relationship to ability to pay, would reduce

pressure to convert the flat-rate residents' charge into a local income tax. In our soundings of Parliamentary colleagues, the back-bench Environment Committee, and the Party's local government supporters we have found a clear majority which favours a mixed system of this sort. The Report (paragraphs 4.17 - 4.20) describes a reasonably simple mixed system that limits local authorities' ability to raise revenue from domestic property and combines the residence and property elements into a single "local charge".

17. The provisional results of the new package, illustrated in Section V of the report, look encouraging. Our proposals on grant and the non-domestic rate reduce average tax bills in 70% of rating authorities. Low spending, high rateable value areas in the South East, West Midlands and East Anglia benefit at the expense of high spending, low rateable value areas in the North and high spending London authorities. With the local charge replacing domestic rates, more households gain from our proposals than lose. These results will be sensitive to the choice of valuation base for the property element. Single adult households pay less than now while large households with 3 or more adults pay more. Since the majority of low income households have only one adult, our package, on average, helps low income households.

18. We shall undoubtedly face criticism over the strong North - South shift implied in these results. Our proposals do mean increases in local domestic tax bills in many Northern areas. But for the most part this is a reflection of how the present system of resource equalisation has grossly overcompensated these areas so that rate bills are very low, despite high spending compared to assessed need. Moderate spending/low rateable value areas in the North will still have domestic tax bills no higher than the national average. The areas in the North which do face the largest increases in domestic tax bills are those where businessmen will derive the greatest benefit from our proposals on the non-domestic rate.

19. We conclude (paragraph 2.9) that special London arrangements should not be needed except for the City of London and that we may also be able to avoid the use of a special city grant. This is encouraging, because either arrangement would be difficult to justify. We may of course need to consider the difficult and recalcitrant problems facing us in the cities in a wider context than that of the finance studies.

20. Despite this satisfactory picture, however, there are bound to be big changes for some businesses and individuals. A carefully-designed transitional scheme will be essential (paragraphs 6.1 - 6.4). We can take advantage of this to phase in the effects of the non-domestic revaluation we require and to cushion the introduction of new domestic property values.

Next steps

21. We should aim to publish a Green Paper about the turn of the year. The Green Paper will need to indicate the main elements of the package we prefer but there could be scope for quite

important detailed modifications. I am quite clear that we should present our proposals as entirely subject to consultation, that is a Green Paper, because we must mount a major campaign of explanation and persuasion in order to secure positive and widespread support. Many pressure groups will be very busy and we must strive to gather behind our proposals as much support as possible from independent and professional bodies who have no party political axe to grind. We must allow at least six months for consultations.

22. If we keep to this timetable we can then announce our decisions before the end of 1986. Not all the matters discussed in the Second Specification Report can be resolved at our September meeting. But to meet this timetable we must ask colleagues for a clear commitment on the general thrust and direction of our proposals to increase local accountability. We will of course come back to E(LF) with further work on certain aspects of the package, in particular the taxation arrangements.

23. I invite my colleagues:

(a) to endorse the broad localist approach of the policies;

(b) to agree the proposals for the national non-domestic rate(paragraphs 4.2 -4.4);

(c) to agree the proposals for needs grant and standard grant, subject to further work on methods of needs assessment (paragraph 4.5 - 4.12) and the implications of expressing the grant total as an assigned share of central revenues (paragraph 4.13 - 4.16);

(d) to indicate their views on the broad acceptability of the local charge proposals (paragraphs 4.17 - 4.20);

(e) to agree that we should aim for publication of a Green Paper about the turn of the year.

K.B.

Department of the Environment
2 Marsham Street
LONDON SW1
13 September 1985

The Local Government Finance Studies

Second Specification Report

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43

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LOCAL GOVERNMENT FINANCE STUDIES

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SECOND SPECIFICATION REPORT

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Presented to the Ministerial Steering Committee on Economic Strategy Sub-Committee on Local Government Finance by the Secretary of State for the Environment and the Minister of State for the Environment, Countryside and Local Government

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13 September 1985

LOCAL GOVERNMENT FINANCE STUDIES

SECOND SPECIFICATION REPORT

I. INTRODUCTION

1.1 The package we put to E(LF) on 20 May had three main components:

a national non-domestic rate set at a uniform rate with the yield pooled centrally and then paid out at a flat rate per adult to all authorities;

a radically reformed grant system with two elements:

- a fixed lump sum needs grant designed to compensate local authorities for differences in their assessed expenditure needs;

- standard grant paid out at a flat rate per adult to all authorities;

a residents' charge payable by all adults and replacing domestic rates.

This regime would mean that adults everywhere would pay the same local tax bill for a reasonable common level of service. For any higher level of service, they would meet the whole of the extra cost.

1.2 Colleagues identified a number of potential difficulties with the package we presented:

- in some high spending authorities, particularly in Inner London, the residents' charge could be unreasonably high;

- there were sharp increases in local domestic tax bills in certain low rateable value areas (e.g. Accrington);

- the package tended to benefit the rich and those in prosperous areas at the expense of the poor and those in less prosperous areas;

- businessmen currently in low rated areas would face significantly higher rate bills as a result of a uniform national non-domestic rate.

We were asked to undertake further work to establish how far these problems could be reduced.

1.3 Section II of the Report, looks at a range of possible levers to mitigate extreme effects in particular geographical areas of the proposed changes.

1.4 Section III of the Report considers possible alternatives for reducing the overall weight placed on the residents' charge. They include:

- transferring the whole of the cost of education to the Exchequer

- increased use of specific grants to support local spending

- introducing a local sales tax or other source of locally variable revenue

- retaining a modified property tax

- assigning a share of national taxation to support local expenditure.

1.5 In the light of the further work we have done we have modified our proposals in certain key respects, particularly in relation to the new local tax. Our revised proposals are set out in <u>Section IV</u>.

1.6 <u>Section V</u> shows the results of our modified package and <u>Section VI</u> looks at the transitional arrangements which may be required before we can move over fully to the new regime.

1.7 We were also asked to study further the arrangements for collecting and administering the residents' charge. The detailed conclusions of that further study are reported in Annex 4. Annex 6 describes the progress on the review of controls on capital expenditure.

1.8 The full list of Annexes to the main Report which deal in more detail with our proposals is:

Annex 1	<u>Non Domestic Rates</u>(Red)
Annex 2	<u>Grant</u> (Yellow)
Annex 3	<u>An extended city grant</u> (Yellow)
Annex 4	<u>Local charge</u> (Blue)
Annex 5	<u>Helping those with low incomes</u> (Green)
Annex 6	<u>Capital</u>
Annex 7	<u>Detailed results</u>
Annex 8	<u>Rejected options</u>

II. MITIGATING EXTREME EFFECTS IN PARTICULAR GRAPHICAL AREAS

2.1 This section looks at five possible ways of modifying the effects of our May package on graphical areas:

a. modifying needs assessments

b. changing the proposals on the non-domestic rate

c. introducing London arrangements

d. introducing a city grant

e. retaining an element of resources equalisation.

a. Needs assessment

2.2 The new grant regime will put much more weight on needs assessment than the present regime. Local residents will bear the full weight of all spending above needs assessment, with no subsidy from the non-domestic ratepayer. This is potentially a very harsh regime for urban authorities. We must therefore ensure that our needs assessments can bear the extra weight we are putting on them, and that no authority is faced with an intolerable level of residents' charge for a reasonable level of spending.

2.3 Our aim is to devise a new method of assessing authorities' spending needs which is simpler to understand than the present system but also picks up the extremes of needs in the inner cities. This work could take several months. In producing figures for this report we have had to use two illustrative working assumptions as proxies for these improved needs assessments:

i. increasing the national Grant Related Expenditure (GRE) control total by £1060m (5.3 per cent) and sharing it between most services in proportion to local authority budgets;

ii. adopting methodological changes to GREs which would be less harsh for the inner cities (these are already on the table for 1986/87).

This gives a general indication of what would happen if we develop needs assessments which reflect the circumstances of inner city authorities in a way appropriate to the new grant structure, but in practice we shall be operating an altogether new (and different) needs assessment system under our new regime.

b. <u>Non-Domestic rates</u>

2.4 Domestic taxpayers in high spending, high resource areas will face larger local tax bills through our proposals to set a national non-domestic rate at the national average, pool the proceeds, and redistribute them to each authority per adult. Non-domestic taxpayers in low spending areas would also face higher tax bills as a result of this change. It would be possible to cap the non-domestic rate and let the proceeds lie locally. That would help to moderate both of these effects.

2.5 We have nevertheless rejected the option of capping the non-domestic rate and letting the yield lie locally:

- it would freeze in perpetuity the present inequitable pattern of non-domestic rate poundages;

- it would be inconsistent for a nationally-set tax to be levied at varying rates across the country on a long-term basis;

- it would either give a huge bonus to authorities with concentrations of non-domestic property or require a large-scale equalising grant to compensate for differences in non-domestic rateable value.

2.6 Once we have improved our needs assessments, we believe that it is justifiable to make local domestic taxpayers bear all of the cost of spending above assessed need.. Transitional measures (discussed later) are the right way to cushion businessmen in low spending areas against the move to a national poundage.

c. <u>City grant</u>

2.7 We could reduce the residents' charge in high spending urban areas by providing additional taxpayer money to support spending in those authorities.

2.8 We have looked further at the idea of a no-strings, "top-up" city grant. There may be some merit in this proposal as a purely transitional measure, to give the authorities time to moderate their spending behaviour and in the meanwhile protect their residents from excessive local taxes. But its only justification for the longer term would be that we lacked faith in the ability of our needs assessment methods to reflect the relative spending needs of the inner cities in full. Our first step is to establish whether we can reform those methods so as to give better needs assessments for the inner cities. Only if we fail to do so will we need city grant as a "topping up" device.

2.9 If it were considered desirable on policy grounds, we could design a City grant which would aim to secure major changes in the spending policies of urban authorities by involving Central Government directly in decisions on the management of main services. Annex 3 sets out the case for going along this road and the practical difficulties we would need to overcome. Our view is that notwithstanding the potential attractions, an approach to urban problems which relied so heavily on the local government finance arrangements would be unlikely to succeed.

d. London arrangements

2.10 We could reduce average domestic tax bills in London significantly by introducing special London arrangements which allowed London authorities to keep some of the benefit of their high non-domestic rateable values. This would be consistent with past grant arrangements. But it is an arbitrary device, which would be difficult to justify within the new regime. It should be adopted only if the new needs assessments fail to cope with extremes of need in London. Special arrangements will however be needed for the City of London, to reflect the abnormal extent to which the City's services are provided to non-domestic ratepayers and non residents.

e. Resources Equalisation

2.11 Residents in low rateable value areas (eg Accrington) face increased tax bills because of the ending of the national taxpayer compensation to them on account of their low rateable values.

2.12 There could be no basis for a resources equalisation grant if we moved to a flat-rate residents' charge based on population.

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2.13 Resource equalisation would also be inappropriate if we retained an element of property tax based on floorspace valuation. This is not a good proxy for the relative taxable capacity of authorities.

2.14 With a property element based on either rental or capital values, we could moderate the losses to low rateable value areas by continuing to equalise rate poundages. But equalisation of rate poundages produces a widely differing pattern of rate bills that vary out of all proportion to ability to pay. It would blur the link between the average local tax bill and the level of an authority's spending - which is the key signal to local taxpayers.

2.15 We have therefore concluded that we should not equalise poundages between areas, even if we retain a property element.

f. Recommendations on the options examined

2.16 We propose that:

i. we rely as far as possible on changes in the pattern of needs assessments to secure more acceptable results for local authority areas;

ii. we rule out capping the non-domestic rate, or allowing its yield to lie locally;

iii. we keep city grant and London arrangements on the table, but only for use as a last resort;

iv. we abandon resources equalisation, even if we retain a property element in the new local tax arrangements.

III. POLICIES TO REDUCE THE OVERALL IMPACT OF THE RESIDENTS' CHARGE ON HOUSEHOLDS

3.1 There are two ways of reducing the overall impact of the residents' charge on households:

a. increase the proportion of local authority spending funded by the national taxpayer;

b. give local authorities a supplementary source of local income.

a. Increasing national taxpayer funding of local services

3.2 The simplest way of reducing residents' charges across the country would be to increase the standard grant payable to all authorities. National taxes would be increased to compensate. If authorities' spending behaviour were unchanged, there would be a uniform cash reduction in the residents' charge in each authority. But the biggest proportional cut would go to the authorities with the lowest residents' charges - which would already be substantially below the previous rate bills. And increasing the dependence of local authorities on government grants would run directly counter to our localist approach.

3.3 We looked at three other possible ways of reducing the aggregate yield of the residents' charge through extra help from the national taxpayer:

i. <u>Transferring the cost of the education service to the Exchequer</u>

We consider that this option should not be pursued:

- if there is no management control of education, then there is no financial control of education;

- it would require a vast new central bureaucracy;
- there would be unconstrained local pressure for extra spending on education;
- it risks higher spending on other local services;
- it would necessitate further reorganisation of local government.

ii. <u>Introducing additional specific grants</u>

We have looked at the option of increasing specific grants to reduce the residents' charge. We do not believe that it is sensible to use specific grants to influence the distribution of local taxes. They should be considered on their own merits as ways of influencing local authority spending priorities.

iii. <u>Assigning a share of national tax to local government</u>

We have rejected this option as a means of reducing residents' charges since it is equivalent to an increase in standard grant (see paragraph 3.2 above).

3.4 Our grounds for rejecting these options are discussed at greater length in Annex 8.

b. <u>An additional local tax</u>

3.5 We have also looked at options which could reduce residents' charges, <u>without</u> increasing national taxation:

i. <u>Local sales tax</u>

We do not recommend this because:

- its yield would lie very unequally across the country and a complicated equalisation grant would be required to limit the massive bonuses which would otherwise go to regional shopping centres;

- many shopkeepers would suffer from cross-border shopping;
- it would be difficult, if not impossible, to operate on present local government boundaries, particularly in densely populated urban areas.

ii. Locally variable Vehicle Excise Duty

We do not recommend this because:

- car ownership is distributed very unequally between authorities - a large equalising grant would again be required;
- it would be almost impossible to operate satisfactorily at London Borough level.

iii. Tourist tax

We do not recommend this because:

- it would help only a few authorities;
- it would run directly counter to initiatives to promote the tourist industry and would add to business costs.

3.6 We have therefore looked again at the fourth option discussed in May for reducing the overall burden of residents' charge : retaining a property element within the local taxation arrangements.

iv. Retaining a property charge

3.7 A property charge alongside residents' charge could certainly reduce the dependence on residents' charge. It has other advantages:

- it reflects the fact that some local authority services undoubtedly benefit property rather than people;

- authorities would have a broader tax base;
- property is a rough proxy for "ability to pay", and including a property charge alongside the residents' charge would reduce pressure to convert the flat-rate residents' charge into a local income tax;

3.8 There are two decisions which we would need to make if we decided to have a property charge:

- first: the valuation base for the property charge. We do not believe that the property charge can be based long-term on existing rateable values. So we need a new valuation base. Our tentative preference is for floorspace - it is simple, and does not require subsequent revaluation. It is a reasonable, though rough and ready, proxy for use of local authority "property services". The alternatives are capital values or a hybrid, like a points system. Annex 4 discusses these options in more detail.

- second: the split between the property charge and the residents' charge. This will be determined by central government. It will affect the distribution of bills between households. We have exemplified a 30:70 split, based on the split between "property" and "people" services. Such a split would reduce everyone's residents' charge by 30%, from an average of £151 (on our spending assumptions) to £105. Alternatives are discussed in Annex 4.

Recommendations

3.9 We do not believe we should increase the amount of Exchequer funding of local authority spending. It goes directly against our local accountability approach.

3.10 We do not believe that a local sales tax, locally variable VED or a tourist tax are practicable or desirable as additional sources of local revenue.

3.11 We believe it is desirable to retain a - much reduced and substantially modified - property element in the new local tax system. Our preliminary view is that the property element should raise 30 per cent of local revenue and be based on floorspace. We believe that retaining a property element will increase the likelihood of our package gaining acceptance among our supporters in Parliament and local government. And it will reduce the pressure to convert the residents' charge into a local income tax.

IV. OUR PROPOSALS

4.1 We are now proposing the following basic package. The detail of our proposals is discussed in Annexes 1 to 6. Table 1 overleaf compares how services will be paid for now and under our proposed regime.

a. Non-domestic rates

4.2 We retain our basic proposal that non-domestic rates should be set nationally, with the yield pooled centrally and distributed as a per adult amount to all authorities.

4.3 In addition we propose:

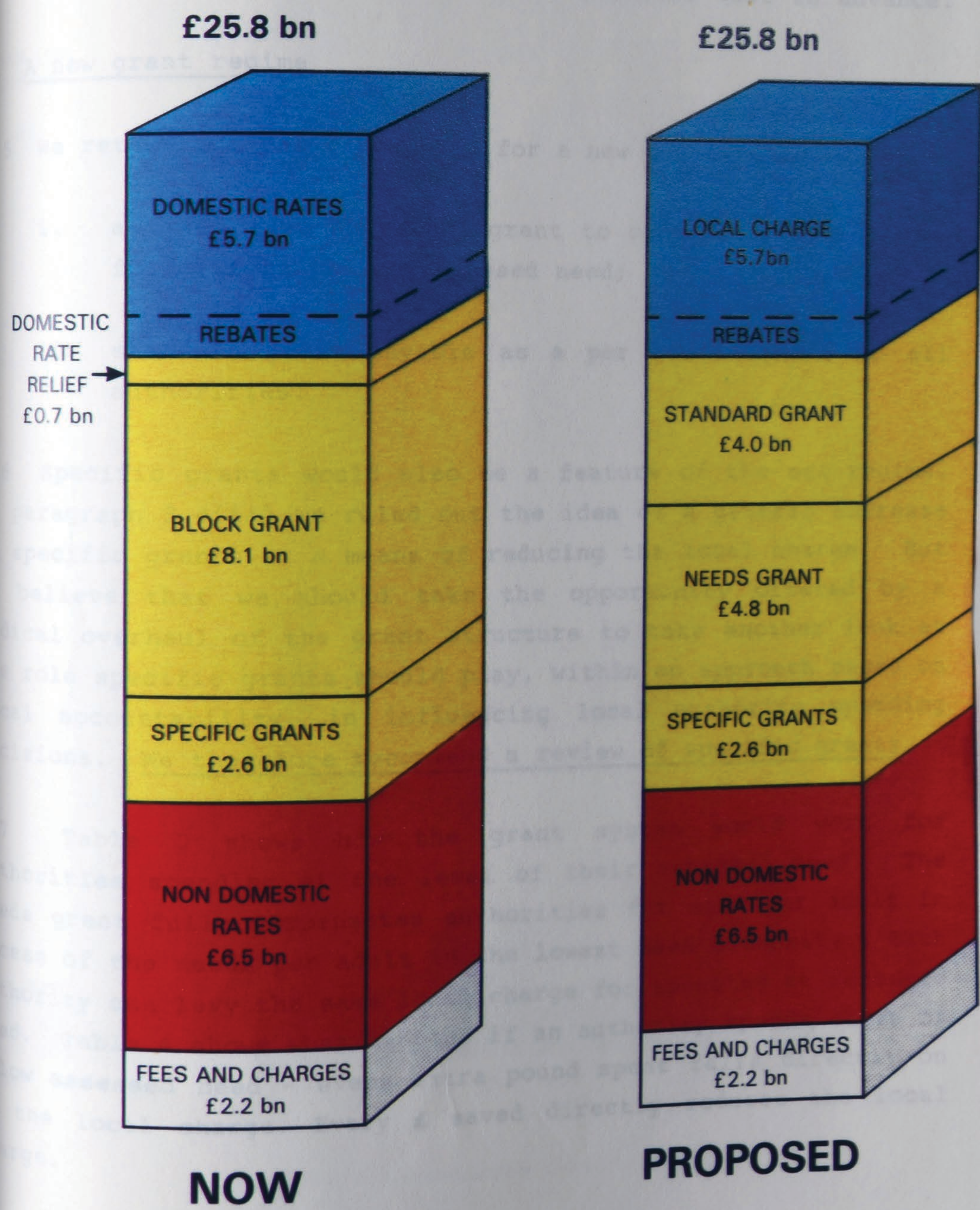
i. that the non-domestic rate poundage should be statutorily indexed to the GDP deflator forecast in the Autumn Statement: this will provide the protection the business organisations seek and would make the whole system more automatic;

ii. that we set the national rate 5 per cent below the average of local rates and allow local authorities discretion to levy a supplementary local non-domestic rateat up to 5 per cent of the national rate. This will first maintain a genuine link between business and local councils and keep a locus for business consultation and second allow us to set a lower rate poundage in year one of our new regime. Most local authorities will doubtless levy the full local rate. But some - particularly low spenders - may levy a lower rate, thus reducing the bill for their non-domestic ratepayers.

iii. that the new rateable values derived from the non-domestic revaluation we have agreed on should be introduced in the same year as the new national rate. Both changes should then be phased in over a 3-5 year period.

TABLE 1

HOW SERVICES ARE PAID FOR



4.4 Table 2 overleaf shows the gainers and losers from setting a rate at the national average (and assuming that all authorities levy the 5 per cent local rate). Reducing the aggregate yield of the non-domestic rate could sweeten the pill. In any case, transitional arrangements will need to be applied to both the new poundage and new rateable values and announced well in advance.

b. A new grant regime

4.5 We retain our basic proposal for a new grant regime with:

i. a fixed lump sum needs grant to compensate authorities for differences in assessed need;

ii. standard grant payable as a per adult amount to all authorities.

4.6 Specific grants would also be a feature of the new regime. In paragraph 3.4(ii) we ruled out the idea of a general increase in specific grants as a means of reducing the local charge. But we believe that we should take the opportunity offered by a radical overhaul of the grant structure to take another look at the role specific grants should play, within an approach based on local accountability, in influencing local authority spending decisions. We therefore recommend a review of specific grants.

4.7 Table 3 shows how the grant system would work for authorities spending at the level of their assessed need. The needs grant fully compensates authorities for need per adult in excess of the needs per adult in the lowest need authority. Each authority can levy the same local charge for spending at assessed need. Table 4 shows what happens if an authority spends above or below assessed need - every extra pound spent falls directly on to the local charge. Every £ saved directly reduces the local charge.

TABLE 2

NUMBER OF NON-DOMESTIC RATEPAYERS IN POUNDAGE BANDS (1984–85 NATIONAL ESTIMATE)

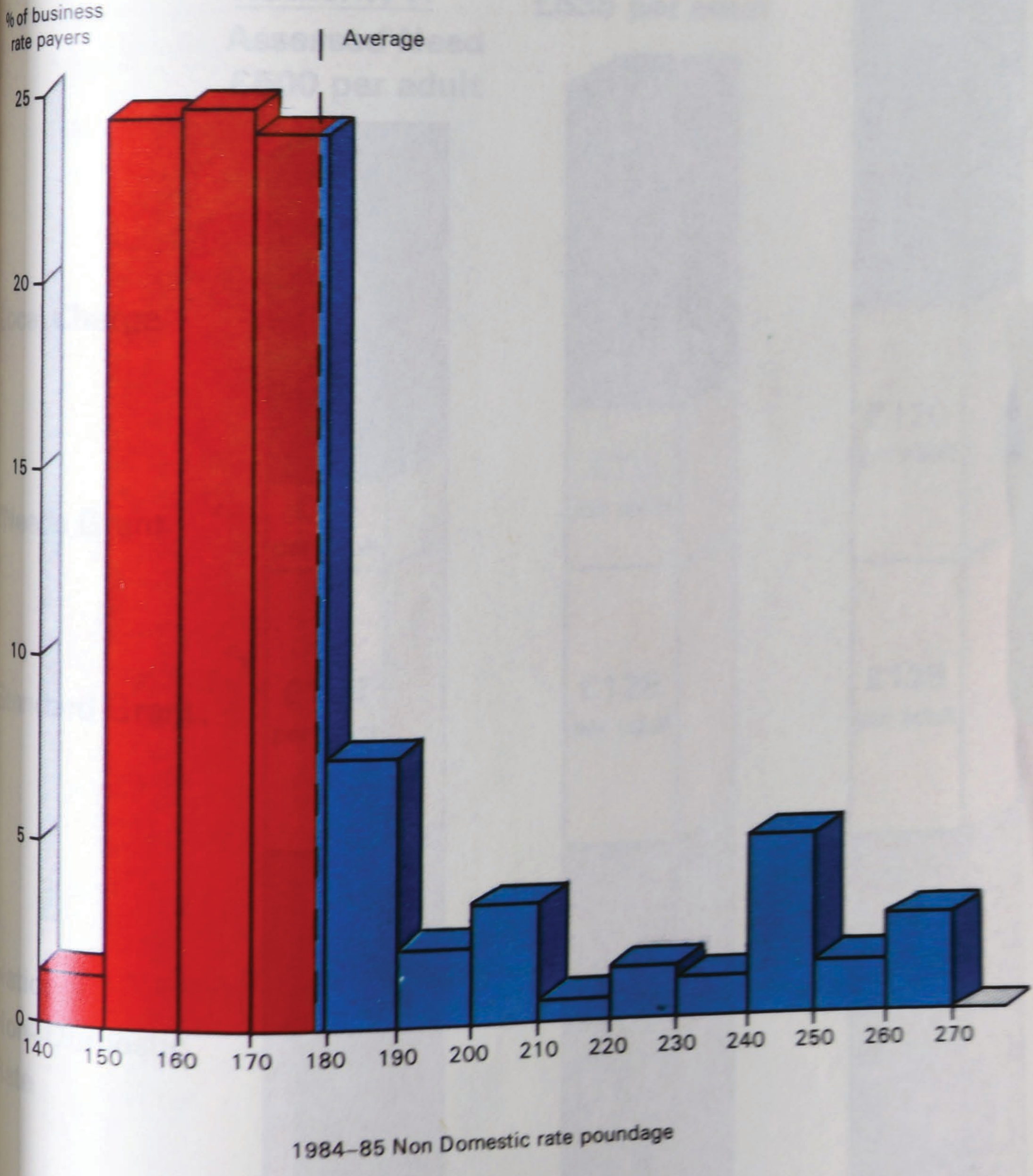


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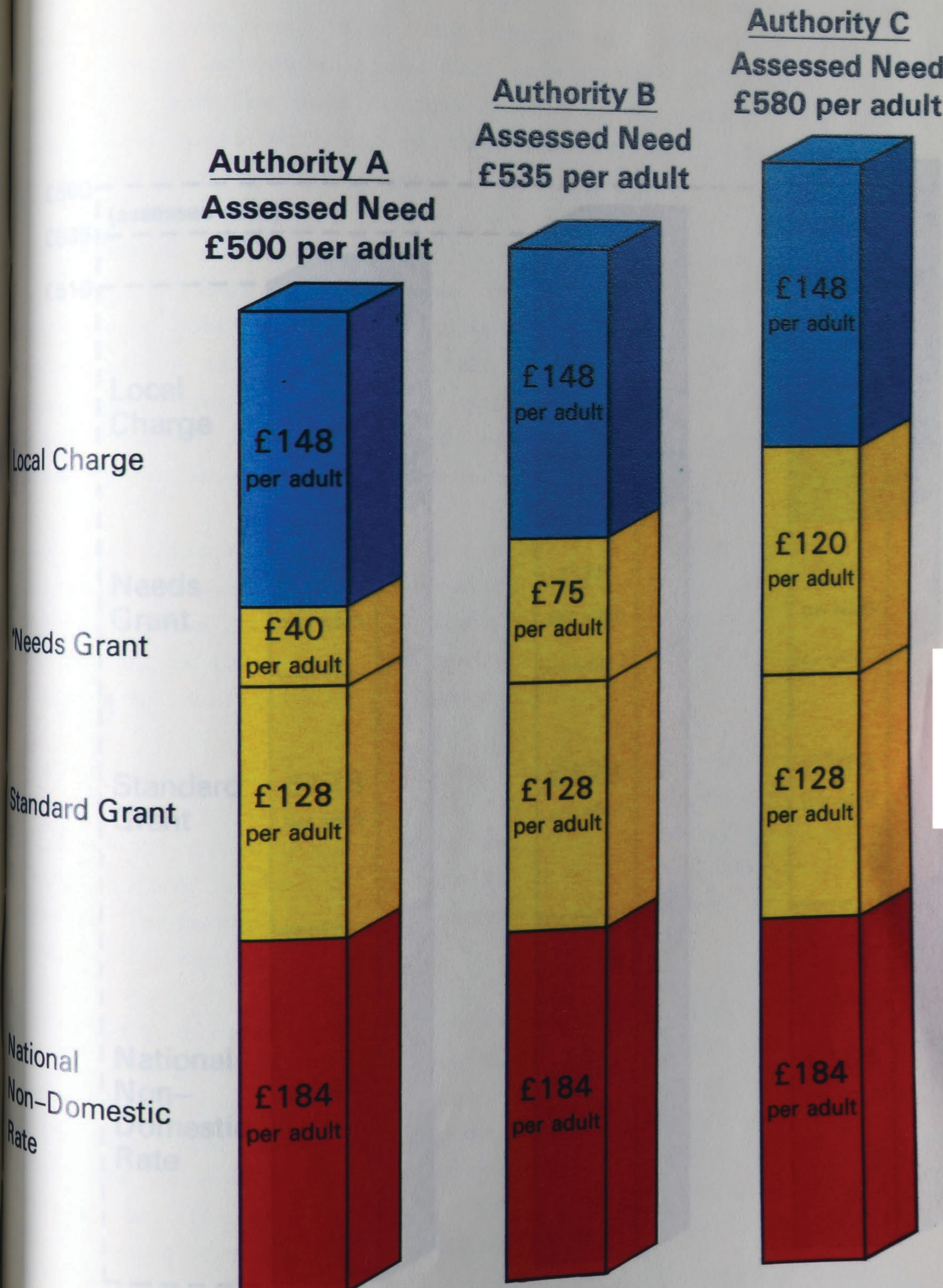
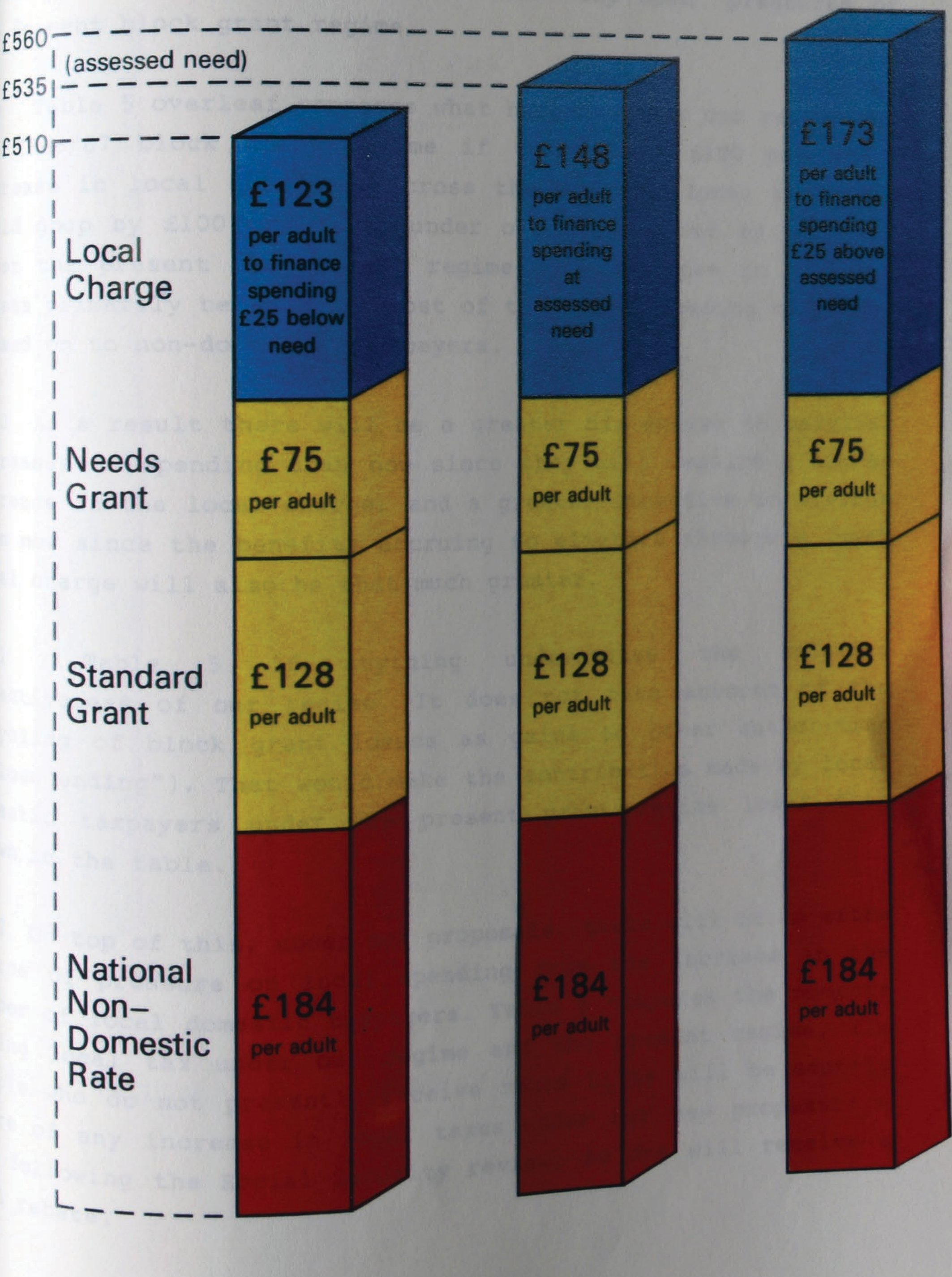
TABLE 3

GRANT AND AVERAGE TAX BILLS FOR SPENDING AT ASSESSED NEED



*Assuming £460 assessed needs per adult for lowest needs Authority

THE EFFECT OF SPENDING VARIATIONS ON AUTHORITY B's LOCAL CHARGE



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4.8 The Government cannot relinquish its interest in the overal level of local authority expenditure and the demands which local government as a whole makes of the taxpayer. Our proposals, operating 'from the bottom up' through radically improved local accountability, will be both more effective in the short term, and far more durable in the longer term, in putting pressure on local authorities than the 'top down' pressures of the present block grant regime.

4.9 Table 5 overleaf compares what happens under our regime and the 1986/87 block grant regime if there is a £100 per adult increase in local spending. Across the country, local tax bills would goup by £100 per adult under our regime, but by only £83 under the present block grant regime. The increase in pressure arises primarily because the cost of the extra spending cannot be passed on to non-domestic ratepayers.

4.10 As a result there will be a greater discentive to marginal increases in spending than now since they will require a higher increase in the local charge, and a greater incentive to savings than now since the benefits accruing to electors through a lower local charge will also be that much greater.

4.11 Table 5 if anything understates the relative effectiveness of our regime. It does not take account of the recycling of block grant losses as gains to other authorities ("close ending"). That would make the contribution made by local domestic taxpayers under the present grant regime lower than shown in the table.

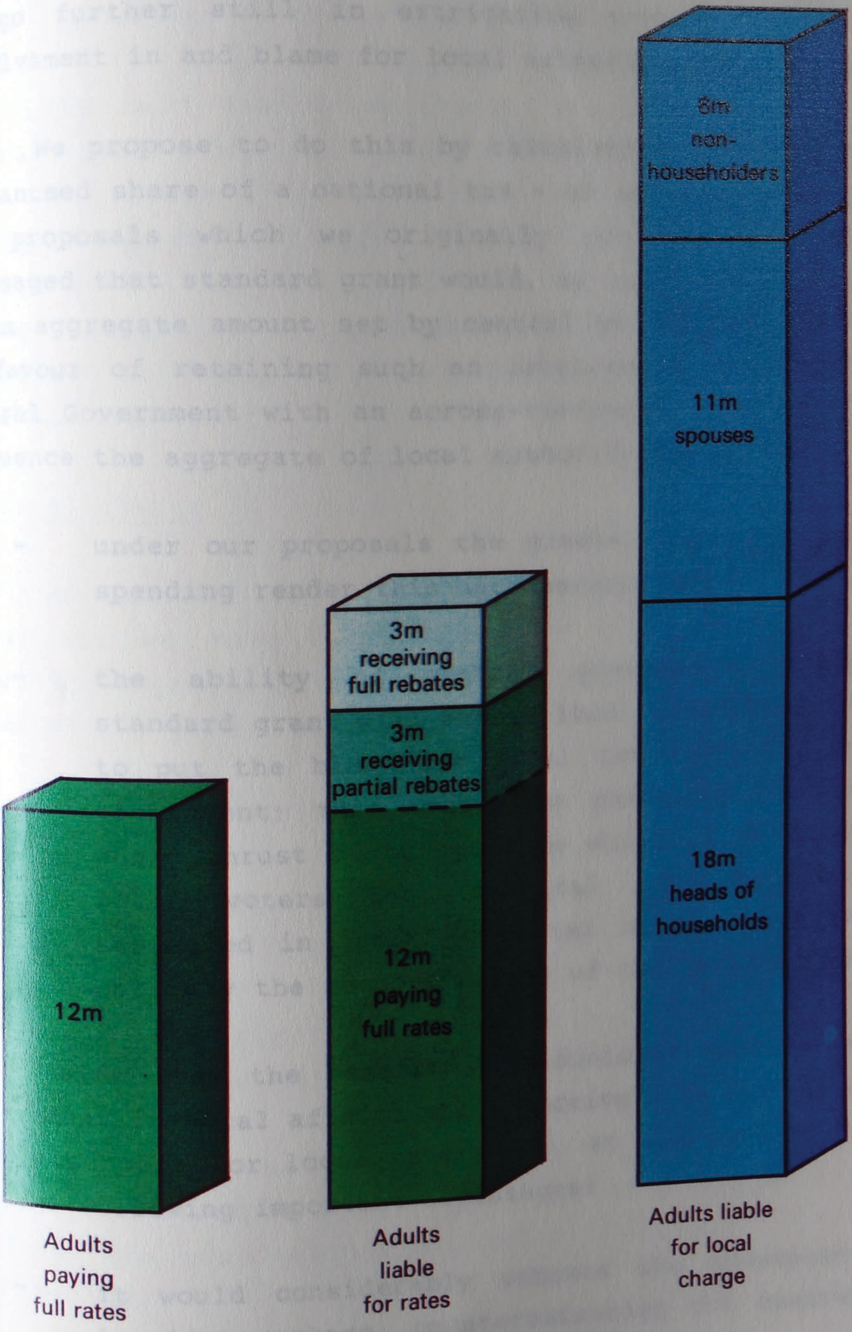
4.12 On top of this, under our proposals, there will be an extra source of pressure on local spending from the increase in the number of local domestic taxpayers. Table 6 compares the numbers paying local tax under our regime and the present regime. 17m people who do not presently receive rates bills will be acutely aware of any increase in local taxes under our new proposals - and following the Social Security review, no one will receive a full rebate.

TABLE 5

SPENDING PRESSURE

TABLE 6

WIDENING THE TAX BASE



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4.13 More effective pressure on spending through improved local accountability will allow central government to forswear the energy and resource-sapping involvement in local authority affairs which has caused so much ill will in recent years, amongst allies and opponents of the Government alike. The greater effectiveness of our proposals will also make it possible to go further still in extricating central Government from involvement in and blame for local authority taxation decisions.

4.14 We propose to do this by calculating standard grant as a guaranteed share of a national tax - an assigned revenue. Under the proposals which we originally put to the Committee we envisaged that standard grant would, as under the present system, be an aggregate amount set by central government. The argument in favour of retaining such an arrangement is that it leaves central Government with an across-the-board lever with which to influence the aggregate of local authority expenditure. But:

- under our proposals the greater marginal pressures on spending render this unnecessary; and

- the ability of central government to manipulate standard grant will enable local government to continue to put the blame for local tax increases on central government; this would run precisely counter to the whole thrust of our package which is to bring home to local voters that marginal spending decisions - reflected in their local tax bills - are solely and entirely the responsibility of the local authority.

4.15 Aside from the benefit of minimising central Government involvement in local affairs and injecting some automaticity into revenue support for local government, an assigned revenue would have the following important advantages:

- it would considerably enhance the presentation of a localist package, counterbalancing the centralising of the non-domestic rate;

- it would make local taxpayers much more aware of the true cost of local services and the extent of the total demands authorities make on them;

- the arguments about the regressiveness or otherwise of the local tax arrangements can be set in the wider context of the national taxation system.

4.16 The main candidates for an assigned revenue to replace standard grant would be a share either of VAT or national income tax. We propose a share of VAT - a share of income tax would inevitably lead to calls for local government to be given discretion to vary the local rate of income tax. On present figures, replacing standard grant with a share of VAT would be equivalent to assigning a quarter of the present VAT yield to local government.

c. Local charge

4.17 We maintain our view that we need a new tax to replace rates; but we have decided that a combined "local charge", comprising a property charge and a residents' charge is a better option than a pure residents' charge.

4.18 The features of the local charge would be:

a. a flat-rate residents' charge, payable by all adults, to raise 70 per cent of local revenue;

b. a property charge, payable by householders, based on floorspace, to raise 30 per cent of local revenue.

Table 7 shows what this would mean for the local tax liability of a sample of typical households. For those receiving benefits, the proposals in the Social Security review have been incorporated.

TABLE 7

LOCAL CHARGE – WHO PAYS WHAT

Average residents' charge = £105

Average property charge = £90

	Married Couple, One working	Married Couple, Both working + 1 unemployed adult	Married Couple + 2 working adults	Single working parent	Multi-occupied house 4 tenants	Single Pensioner on Supplementary Benefit
They pay now:	£300	£300	£300	£300	£300	£60
They will pay:	£300 (property charge, 2 residents' charges)	£321 (property charge, 2 full residents' charges; 1 rebated residents' charge)	£510 (property charge + 4 residents' charges)	£195 (property charge + 1 residents' charge)	£510 (property charge + 4 residents' charges)	£39 (20% of property charge and 1 residents' charge)
Difference:	–	+ £21	+ £210	– £105	+ £210	– £21

4.19 There would be rebates for low income households, along the lines of the rebate scheme for rates envisaged in the Social Security review. Widening the tax base will inevitably increase the rebate caseload - we estimate by 0.7m. It will increase expenditure on benefits by £35m. We believe that is a price worth paying for the improvement in accountability.

4.20 The property charge raises no major new issues of administration. The residents' charge does. These are discussed in Annex 4. The main features of residents' charge are:

i. all adults to be liable to the charge in the authority where they have their "main or only residence";

ii. a collective charge on communal residences;

iii. a property charge and a single residents' charge to be levied on second homes;

iv. the register for the residents' charge to be a rolling register, separate from the electoral register; householders would be required to register all those for whom the property was the "main or only" residence;

v. enforcement to be the responsibility of local authorities, using data available to them.

Conclusions

4.21 Taken together we believe these proposals form the basis of a fairer system of local taxation and a self-regulating system which will substitute bottom-up pressures on local spending for the present top-down pressures, which we believe cannot be sustained in the medium-term.

4.22 We need to reinforce these major changes with the other changes which we presented to E(LF) in May. We propose that future meetings of E(LF) should consider proposals on:

- a tighter budgetary framework, to constrain local authorities' capacity to manipulate their accounts in a way which damages their accountability to local voters;
- increased fees and charges to increase the amount of money local authorities raise to finance their services from consumers who choose to pay rather than local taxpayers, and thus to promote efficiency in the provision of local services;
- annual elections to ensure that local councils are called to account by their electors each year and reduce the scope for manipulation of spending and tax increases in election years.

Capital controls

4.23 A further important outstanding issue is the future of the capital control system, which has been discussed outside E(LF). The state of play so far is described in Annex 6.

4.24 Consistent with our reliance on bottom up pressure to control revenue-financed current expenditure, our preference on capital would be to control the net external borrowing of individual authorities rather than their gross or net capital expenditure. Central government's primary interest would then be in that aspect of the local authority capital expenditure system, namely borrowing, which directly affects the PSBR. Capital financed from revenue would be subject to the same pressures as current spending financed from revenue. However there are some formidable practical problems which need resolution before we can finally opt for that approach. The five options for dealing with capital which we outlined in our Specification Report must remain on the table for the moment. We shall report back separately later this Autumn with proposals.

V. RESULTS

5.1 Our results relate to England only and are based on the proposals set out above. Our May figures were based on local authorities' 1984-5 spending patterns. They overstated the likely tax bills in some high spending areas under the new regime because they took no account of reductions in spending likely to arise through precept limitation on the new joint boards and ILEA. We have adjusted the spending figures to reflect this. Our new figures do not however show the impact of the spending pressure being put on high spenders through rate limitation and the block grant system. To that extent, local tax bills in high spending areas remain overstated.

5.2 Incorporating the spending changes we have assumed reduces the overall yield of local taxes by just under 6 per cent. The reductions are significant for Greater London (because of ILEA) and South Yorkshire (because of transport subsidies). Comparing tax bills under the new system, incorporating these reductions, with present rates bills will tend to overstate the gains/understate the losses that will be perceived in these areas arising from the change to the new system.

5.3 Our results are in two parts:

- effects of our proposals on areas;

- effects of our proposals on households.

A more detailed commentary on the results is given Annex 7.

a. <u>**Effects on Areas.**</u>

5.4 The shifts in average local tax bills between authorities are caused by our proposals on grant and the non-domestic rate, **not** the switch from domestic rates to the local charge which only affects the distribution of tax bills within an area .

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5.5 Compared with the results we showed in May, there is a more tolerable pattern of local tax bills in high spending areas. Only 8 authorities would have average local domestic tax bills of more than £400 per adult, compared with 13 in our May figures and 4 authorities at present in this position. All these are inner London authorities spending well in excess of their assessed spending needs.

5.6 The overall picture is as follows:

Change in average domestic tax bill per annum £/adult.	No. of rating authorities	Nos of adults in these authorities
Increases		
more than £100	8	1.1m
£50 - £100	20	2.8m
£0 - £50	83	9.3m
Reductions		
£0 - £50	172	14.3m
£50 - £100	76	7.1m
more than £100	7	0.6m
All authorities	366	35.2m

5.7 By comparison with the existing regime, average domestic tax bills would rise in 111 rating authority areas (30%) and would fall in 255 areas (70%). Average domestic tax bills would fall in shire areas by 18% and would increase in metropolitan areas outside London by 3%. There is a strong regional pattern:

- average domestic tax bills in the Northern region and Yorkshire and Humberside rise by between one quarter and one third, reflecting the combined effectof the national non-domestic rate and the ending of resource equalisation.

- average domestic tax bills in London rise by 13% mainly as a result of high spending in Inner London.

- in the South East and West Midlands average tax bills would fall by up to a third.

The results for selected authorities are illustrated more fully in Table 8.

5.8 In Sections II and III we discussed certain supplementary levers to damp down the pattern of gains and losses. Table 9 shows the effects of pulling these levers.

- Using the whole of VED and 1% VAT as assigned revenues reduces average local tax bills by £45 and £27 respectively.

- Special London arrangements (in this case, paying 5% of Inner London's rateable value into a pool which was then distributed at a flat rate £ per adult to Inner London's authorities only) would reduce domestic local tax bills per adult in Inner London by £38, at the expense of a £2 increase in the rest of the country.

- City grant (in this case set at 5% of selected authorities' budgets) would reduce average domestic local tax bills per adult in the authorities concerned by between £20 and £60;

TABLE 8

EFFECT OF REVISED LGFS PROPOSALS ON AREAS

...rspend ...r adult ...gainst ...ent GRE	Cost Per Adult: Now	Cost Per Adult: Chequers package	Effect On Cost Per Adult Of: Revised spending assumption	Effect On Cost Per Adult Of: Revised GREs	Effect On Cost Per Adult Of: 5% local non-domestic rates	Revised LGFS Package: Per adult local tax bill	Revised LGFS Package: Total change from now
Col 1	Col 2	Col 3	Col 4	Col 5	Col 6	Col 7	Col 8
LONDON HIGH SPENDING (20)							
473.30	£303.28	£590.55	–£111.56	–£84.40	–£15.45	£379.13	£ 75.85
517.71	£386.76	£634.95	–£111.56	£10.21	–£19.07	£514.54	£127.78
520.09	£321.28	£637.33	–£111.56	–£ .60	–£18.19	£506.98	£185.70
291.28	£319.77	£408.53	–	–£39.44	–£ 1.57	£367.51	£ 47.74
LONDON/MET GAINERS (27)							
27.64	£140.14	£ 89.60	–£ 7.11	–£ 6.04	–£ .65	£ 75.81	–£ 64.33
52.52	£206.23	£169.77	–	–£15.19	–£ 4.09	£150.48	–£ 55.75
302.77	£473.20	£420.01	–£111.56	–£10.61	–£62.83	£235.02	–£238.18
33.78	£174.58	£151.03	–£ 24.63	–£ 2.47	£ 3.44	£127.36	–£ 47.22
METROPOLITAN LOSERS (22)							
20.75	£102.36	£137.99	–£ 6.61	–£ 3.11	£ 3.20	£131.47	£ 29.11
153.06	£190.11	£270.30	–£ 3.52	–£18.06	–£ 1.61	£247.11	£ 57.00
161.42	£161.46	£278.66	–£50.23	£ 1.46	£ 1.55	£231.45	£ 69.99
162.00	£194.13	£279.25	–£15.10	£ 4.87	£ .03	£269.05	£ 74.92
SHIRE GAINERS (227)							
27.36	£195.46	£ 89.88	–	£ 6.21	–£ 1.34	£ 94.76	–£100.70
7.27	£140.70	£124.51	–	–£ .55	£ 2.41	£126.37	–£ 14.33
11.17	£184.30	£106.08	–	£11.75	£ 1.40	£119.23	–£ 65.07
12.09	£127.32	£105.16	–	–£ 1.44	£ 1.14	£104.85	–£ 22.47
3.95	£210.07	£121.20	–	£ 8.05	–£ .11	£129.14	–£ 80.93
SHIRE LOSERS (69)							
16.33	£ 88.49	£133.57	–	£ 5.23	£ 3.43	£142.23	£ 53.74
4.36	£ 83.35	£112.88	–	£ 9.62	£ 3.76	£126.26	£ 42.92
8.20	£ 90.25	£125.44	–	£ 2.30	£ 3.77	£131.51	£ 41.26
29.92	£ 89.30	£147.17	–	£ 1.86	£ 3.63	£152.65	£ 63.35

* SAMPLE AUTHORITIES

EFFECT OF SUPPLEMENTARY LEVERS

	Revised LGFS package tax bill per adult	Effect On Local Tax Bill Per Adult				
		VED used as assigned revenue	1% VAT used as assigned revenue	Special London arrangements	5% city grant	Local Charge with resource equalisation
	Col 1	Col 2	Col 3	Col 4	Col 5	Col 6
*	**LONDON HIGH SPENDING (20)**					
1	£379.13	–£45.06	–£27.72	–£38.22	–£53.65	£15.77
2	£514.54	–£45.06	–£27.72	–£38.22	–£56.71	£18.17
3	£506.98	–£45.06	–£27.72	–£38.22	–£56.15	£15.32
4	£367.51	–£45.06	–£27.72	£ 2.09	–£44.73	£10.76
*	**LONDON/MET GAINERS (27)**					
5	£ 75.81	–£45.06	–£27.72	£ 2.09	–£21.93	£ .43
6	£150.48	–£45.06	–£27.72	£ 2.09	£ 8.74	£15.40
7	£235.02	–£45.06	–£27.72	–£38.22	£ 8.74	£20.84
8	£127.36	–£45.06	–£27.72	£ 2.09	–£20.54	–£ .11
*	**METROPOLITAN LOSERS (22)**					
9	£131.47	–£45.06	–£27.72	£ 2.09	–£23.16	–£12.45
10	£247.11	–£45.06	–£27.72	£ 2.09	–£32.73	–£ 5.15
11	£231.45	–£45.06	–£27.72	£ 2.09	–£23.60	–£10.94
12	£269.05	–£45.06	–£27.72	£ 2.09	–£27.99	–£ 6.71
*	**SHIRE GAINERS (227)**					
13	£ 94.76	–£45.06	–£27.72	£ 2.09	£ 8.74	£ 8.07
14	£126.37	–£45.06	–£27.72	£ 2.09	£ 8.74	–£ 6.24
15	£119.23	–£45.06	–£27.72	£ 2.09	£ 8.74	£11.02
16	£104.85	–£45.06	–£27.72	£ 2.09	£ 8.74	£ .22
17	£129.14	–£45.06	–£27.72	£ 2.09	£ 8.74	£ 9.01
*	**SHIRE LOSERS (69)**					
18	£142.23	–£45.06	–£27.72	£2.09	£ 8.74	–£12.03
19	£126.26	–£45.06	–£27.72	£2.09	£ 8.74	–£12.59
20	£131.51	–£45.06	–£27.72	£2.09	£ 8.74	–£ 9.72
21	£152.65	–£45.06	–£27.72	£2.09	£ 8.74	–£ 9.89

*SAMPLE AUTHORITIES

- Resources equalisation (if we had a property element based on present rateable values and used a lump sum resources grant to compensate for differences in rateable value for spending at assessed need) would reduce local tax bills by up to £15 in low rateable value areas, and increase average local tax bills by up to £20 in high rateable value areas.

5.9 We concluded that we should rule out the use of an assigned revenue and resources equalisation to damp down gains and losses. City grant and London arrangement would be used only if there were major problems with needs assessments.

b. Effects on households

5.10 In showing the effects of our proposals on individual households, we have assumed implementation of both the Social Security review and personal taxation proposals currently in the pipeline. We have used purely illustrative sets of policy assumptions. The objective in this report is to isolate the effects of our local finance proposals, and so we have built the social security and income tax policy assumptions into the net tax bills and net income under both the present regime and our proposed regime.

5.11 Table 10 shows the effects of our proposals on households by region. The results are shown in terms of net changes in weekly local tax bills for households both in £'s and as percentages of net income, compared to present rate bills. They are therefore subject to the health warning in paragraph 5.2.

5.12 The main features to emerge from the table are as follows:

- More households gain than lose. 10.5m households (59%) in England gain, while 7.3m (41%) lose.

TABLE 10

LGFS REVISED PACKAGE (LOCAL CHARGE) NUMBER OF GAINERS AND LOSERS: HOUSEHOLDS

	England millions	England %	Northern %	Yorks & Humbs %	East Midlands %	East Anglia %	Greater London %	South East %	South Western %	West Midlands %	North Western %
POUNDS PER WEEK											
LOSERS											
10+	.1	0	0	0	–	–	2	–	–	–	0
5-10	.3	2	4	2	0	0	9	0	0	0	1
2-5	1.6	9	26	18	6	2	17	1	3	2	12
0-2	5.3	30	52	54	39	20	32	12	30	15	36
Total Losers	7.3	41	81	73	45	22	60	13	34	16	49
GAINERS											
0-2	6.9	39	17	23	42	58	27	46	49	53	38
2-5	2.9	16	2	3	12	17	11	32	15	26	11
5-10	.6	3	0	0	1	2	3	8	2	4	2
10+	.1	0	–	–	–	0	1	1	0	0	0
Total Gainers	10.5	59	19	27	55	78	41	87	66	84	51
PERCENTAGE OF NET INCOME											
LOSERS											
10+	.0	0	–	–	–	–	0	–	–	–	0
5-10	.1	0	1	0	–	–	2	–	–	–	0
2-5	.8	5	13	7	1	0	15	0	1	0	4
0-2	6.5	36	67	66	43	22	43	13	33	16	44
Total Losers	7.3	41	81	73	45	22	60	13	34	16	49
GAINERS											
0-2	8.7	49	18	25	50	68	32	69	58	67	45
2-5	1.5	8	1	2	5	9	7	15	7	15	5
5-10	.2	1	0	0	1	1	1	2	1	2	1
10+	–	–	–	–	–	–	–	–	–	–	–
Total Gainers	10.4	59	19	27	55	78	40	86	66	83	51

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- There are more large gainers than large losers. 3.6m households (20%) have reductions in their local tax bills of more than £2 per week, while 2.0m households (11%) face increases of more than £2 per week.

- 1.7m households (10%) have reductions in their local tax bills of more than 2% of their net income; 900,000 (5%), have increases of more than 2 per cent of net income.

- For most households, the changes are relatively small. For 12.2m households (69%), local tax bills change by less than £2 per week.

5.13 Table 11 overleaf brings out clearly the strong regional pattern to the results:

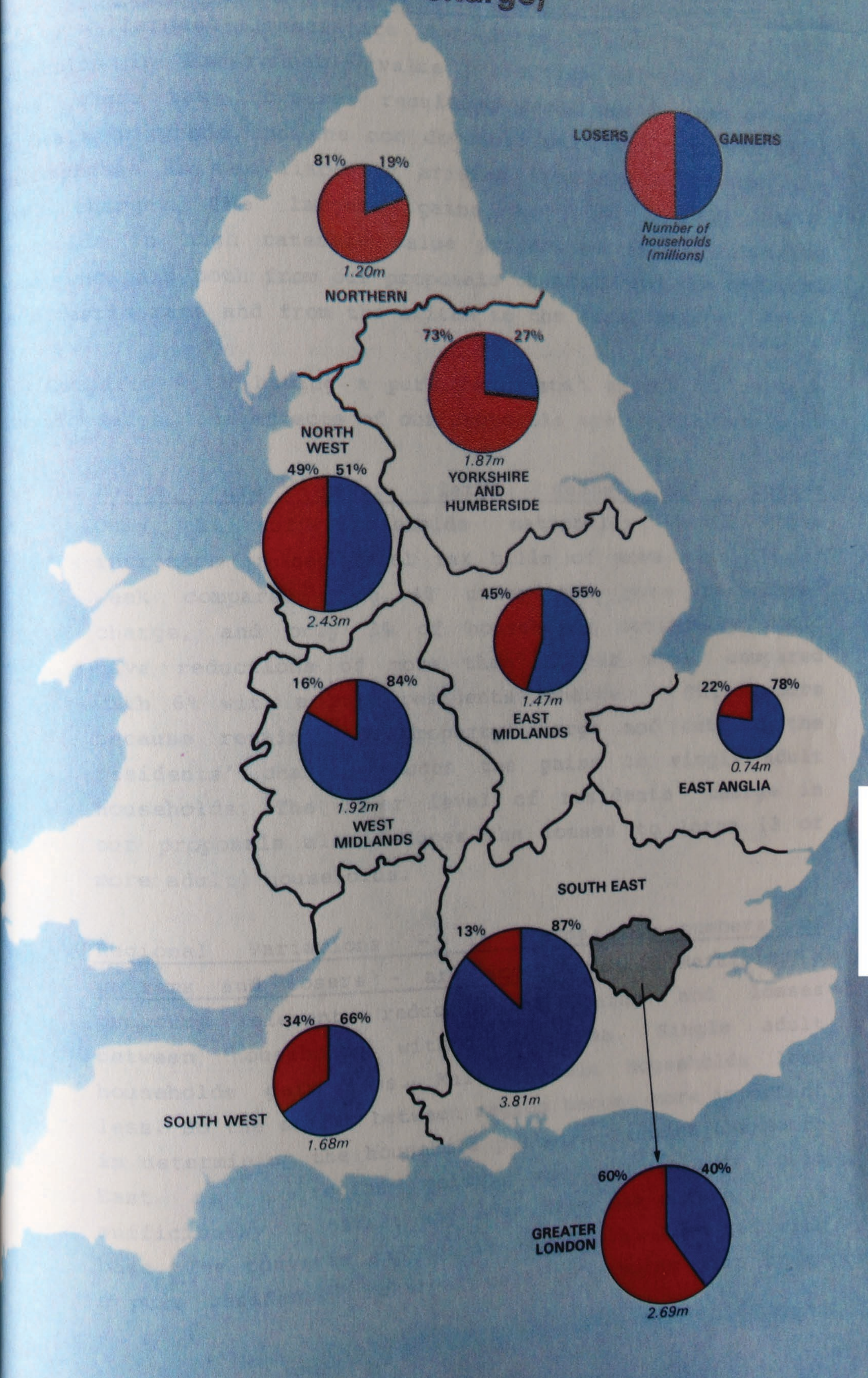
- Over three quarters of households in East Anglia, the West Midlands and the South East (excluding London) gain. This particularly reflects the benefit of pooling the non-domestic rate for these low spending areas as well as the effect of ending domestic resources equalisation.

- Over two thirds of households in the North and Yorkshire and Humberside - high spending/low resource areas - lose for the same reasons.

- 60% of households in Greater London lose, despite the ending of resources equalisation, because of high spending by Inner London authorities.

TABLE 11

HOUSEHOLDS GAINING AND LOSING BY REGION
(with local charge)



5.14 The largest losses are for large (3 or more adult) households in low rateable value properties in high spending areas, where tax increases resulting from the impact of our proposals on grant and the non domestic rate are combined with the increase in tax liability arising from the switch to the local charge. The largest gains are for single adult households in high rateable value properties in low spending areas, who gain both from our proposals on grant and the national non domestic rate and from the switch to the local charge.

5.15 Compared with having a pure residents' charge to replace domestic rates, the effects of our proposals are as follows:

- <u>There are fewer large gains and losses</u> Only 2% of households nationally would have increases in net local tax bills of more than £5 per week compared with 4% under the pure residents' charge, and only 3% of households nationally would have reductions of more than £5 per week, compared with 6% with a pure residents' charge. This occurs because retaining a property charge and cutting the residents' charge reduces the gains to single adult households. The lower level of residents' charge in our proposals also reduces the losses to large (3 or more adult) households.

- <u>Regional Variations - in terms of numbers of gainers and losers - are accentuated</u>. Retaining a property element reduces the gains and losses between households within an area. Single adult households gain less. Multi- adult households lose less. So the shifts between region become more important in determining the household pattern. Because the South East as a region gains, most households gain sufficiently to offset any loss from the change in tax base. The converse applies in the North. Compared with a pure residents' charge, more households gain under our proposals in East Anglia, West Midlands and the South East, and more householders lose in the North and Yorkshire and Humberside. For example, the proportion of households in the South East who gain is increased from 82% under the pure residents' charge to 87% under the proposed local charge while the proportion of households in the Northern Region who lose is increased from 72% to 81%.

5.16 Our figures have assumed existing rental based property values. A different valuation base would be likely to change the distribution between households.

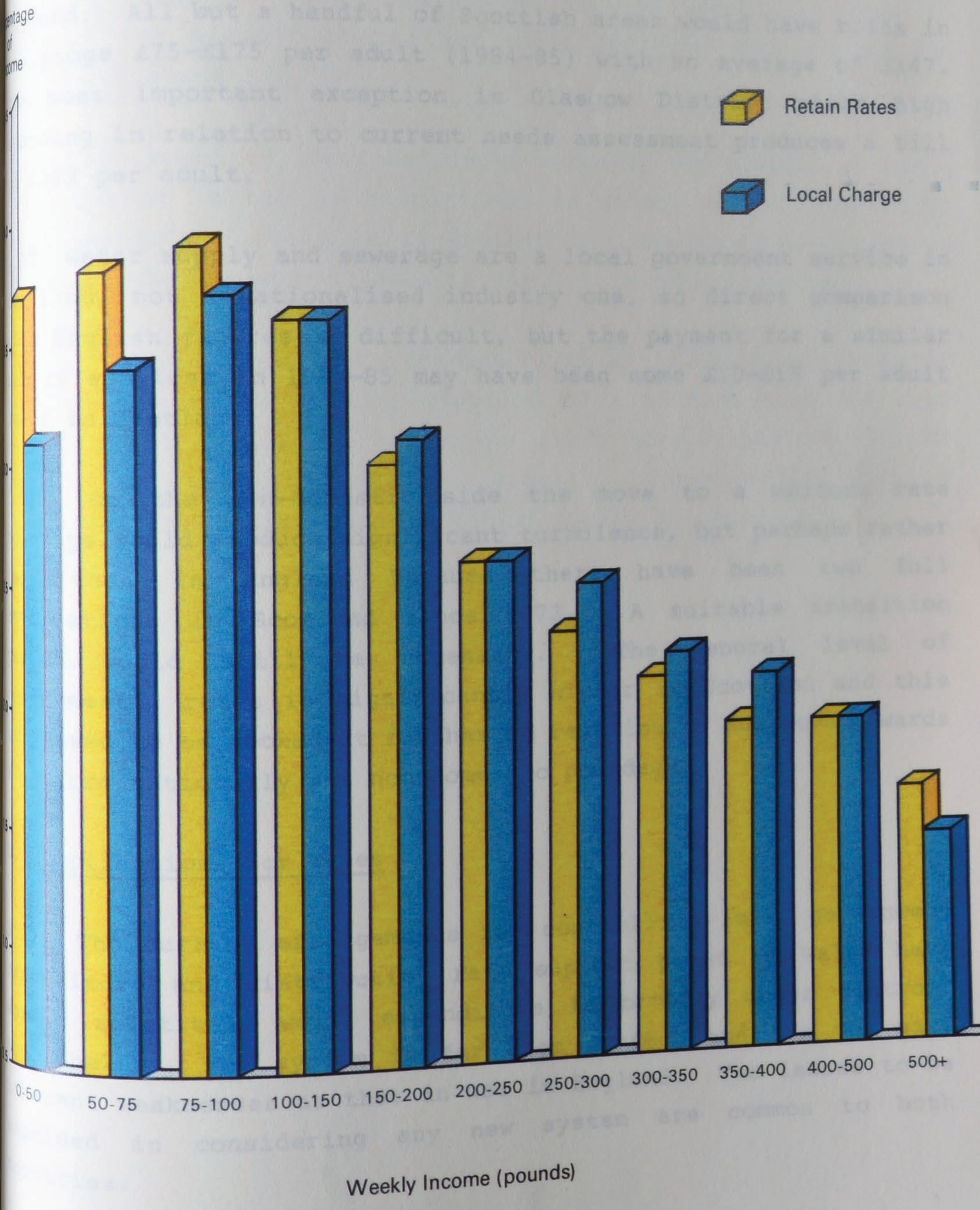
5.17 Colleagues have been concerned that the new tax regime might be more regressive than domestic rates. Table 12 shows the effects on households across the income bands if we move from domestic rates to our new local charge. The results suggest that, on average, low income households would pay a smaller proportion of net income in local taxes under the proposed local charge than under domestic rates. The main reason for this is that the majority (more than 60%) of low income households contain only one adult. At the other extreme, households with very high income are also significantly better off. This is because they tend to have high rateable value properties and benefit from the switch to the local charge, even though many high income households also have 3 or more adults. This point is discussed more fully in Annex 7.

c. Implications for Scotland

5.18 The problems of the existing rating system and the issues to be faced in introducing any alternative are similar in Scotland. The reaction to this year's general revaluation in Scotland has provided a vivid illustration of the shortcomings of the present system.

TABLE 12

NET LOCAL TAX AS A PROPORTION OF INCOME
(average for income band)



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5.19 The main presentation of this report is in English terms but work has been done to illustrate the effects of a parallel new system of financing local government within Scotland. The figures suggest that average local tax bills per adult in Scotland would show rather less extreme variation than in England. All but a handful of Scottish areas would have bills in the range £75-£175 per adult (1984-85) with an average of £147. The most important exception is Glasgow District where high spending in relation to current needs assessment produces a bill of £193 per adult.

5.20 Water supply and sewerage are a local government service in Scotland, not a nationalised industry one, so direct comparison with English figures is difficult, but the payment for a similar set of services in 1984-85 may have been some £10-£15 per adult lower in Scotland.

5.21 On the non-domestic side the move to a uniform rate poundage would produce significant turbulence, but perhaps rather less than in England because there have been two full revaluations in Scotland since 1973. A suitable transition period would still be necessary. The general level of non-domestic rates is significantly higher in Scotland and this will need to be looked at further in relation to any move towards a uniform nationally set non-domestic poundage.

d. Implications for Wales

5.22 The current arrangements for controlling local government expenditure and distributing rate support grant in Wales have worked relatively well; expenditure is broadly under control. Nevertheless, the system is far from perfect and has the same inherent weaknesses as that in use in England. The issues to be examined in considering any new system are common to both countries.

5.23 The proposals outlined in this report can be operated in Wales modified as necessary to reflect Welsh circumstances. The influence of the main components of the proposed arrangements has been assessed and the results suggest that, as in Scotland, the introduction of a pure residents' charge would produce a far narrower range of local tax burden on the individual than in England; the highest charge per adult would be around £145 and the lowest about £70.

5.24 The impact of incorporating a property tax element within a local charge is not as significant in Wales, at the individual local authority level, as in England but the broad direction of change at the household level is similar in both countries.

5.25 Given the relatively compact range of existing non domestic poundages in Wales the introduction of a uniform rate for this sector would result in a smaller shift than elsewhere in the pattern of taxation between areas. Consequently only a relatively short transitional period should be necessary.

6.4. Transitional arrangements for <u>local authority areas</u> need further consideration. Until we have seen the results of our new needs assessment methodologies, we shall not be able to consider what arrangements might be needed to phase in the effects of the package on authorities. As well as conventional safety nets we might need to look to transitional London arrangements or a transitional city grant if London or inner City authorities faced acute temporary problems before they reduced their spending to levels which would produce tolerable local tax bills.

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VII. CONCLUSIONS

7.1 In the light of the work we have done since the last meeting of E(LF) we have modified our original proposals. The reforms we now advocate are:

i. a uniform national non-domestic rate, with a small, discretionary element, to be introduced at the same time as the new non-domestic rateable values. The proceeds of the national rate to be pooled and redistributed on a per adult basis;

ii. a radically simplified grant structure, based on an improved method of assessing spending need;

iii. replacing domestic rates with a local charge comprising a residents' charge, paid by all adults, to raise 70 per cent of local revenue and a property charge, on a new valuation basis to raise 30 per cent.

7.2 This package offers the prospect of a stable and self-regulating system of local government finance, in which central government will be able to extricate itself from detailed intervention in individual local authority spending decisions. The panoply of central controls we have had to develop will be replaced by more effective <u>local</u> pressures.

DEPARTMENT OF THE ENVIRONMENT

September 1985

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ANNEX 1

NON-DOMESTIC RATES

A. INTRODUCTION

1.1. The main Report sets out our proposal to set a uniform non-domestic rate with proceeds pooled centrally and redistributed per adult to each local authority to support local authority expenditure. Taking the power to set the non-domestic rate away from local authorities will place the full burden of financing any increase in spending on local domestic taxpayers. Business ratepayers will no longer be subject to volatile movements in the business rate. At E(LF) some concern was expressed at the size of the gains and losses for non-domestic ratepayers and local tax payers entailed in moving to a uniform rate with proceeds pooled centrally. This Annex discusses alternative approaches and the mechanics of working a uniform non-domestic rate.

B. ALTERNATIVE APPROACHES

1.2. Setting a rate designed to yield the same as the present real yield of the non-domestic rate will mean that non-domestic ratepayers in all authorities with rates <u>above</u> the national average will enjoy a reduction in their rate poundage and in all authorities with rates <u>below</u> the national average face an increase in their rate poundage. We have looked at alternative ways of achieving the objectives set out in paragraph 1, while avoiding the problems posed by the gainers and losers from setting a national non-domestic rate poundage.

1.3. A <u>freeze</u> on the present non-domestic rate poundages would avoid any gainers or losers, but would mean a progressive fall in the real yield of the non-domestic rate which would have to be made up through another source of income. To avoid a progressive increase in domestic taxes, the loss of revenue would have to be made up through an increase in another business tax.

In general, they do not have as wide a coverage as non-domestic rates. A new business tax, such as a payroll tax, which would directly tax jobs, would be equally undesirable. Moreover it would take a long time for the yield of £6.5 bn to "wither on the vine" and in that period the unfairness and burden of the present spread of rate poundages would be perpetuated. We do not see a freeze as an acceptable option.

1.4. <u>Capping</u> existing non-domestic rate poundages (ie allowing them to rise by no more than a specified percentage each year) but still pooling the proceeds would be less disruptive to nondomestic ratepayers than setting a uniform rate: non-domestic rates would not need to increase in low spending areas. And the permanent protection from excessive rate increases for all businesses would be clear and tangible bonus for them. But it would freeze in perpetuity the present wide range of non-domestic poundages - the Newcastle businessman would, at the end of the century, still be paying twice as much as the Croydon businessman because of Newcastle's spending policies in the year before capping was introduced. In the long- term we do not believe it would be acceptable to levy a national tax at widely different rates across the country. We have therefore concluded that capping historic poundages cannot be justified as a long-term option.

1.5 We believe that the problems of gains and losses for non-domestic ratepayers arising from the introduction of a uniform non-domestic rate is best tackled by suitable transitional arrangements. These are discussed in paragraphs 1.30 and 1.31.

1.6. The proposal in the main Report is that the income from the uniform non-domestic rate should be pooled centrally and redistributed as a fixed amount per adult to each authority to reduce the size of the residents' charge. As was noted previously, this proposal produces some large increases in domestic tax bills in those authorities which have high non-domestic rateable values, or high poundages, or both. The alternative approach of capping the non-domestic rate and

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allowing the proceeds to lie locally would deal with this problem and maintain the link between ratepayers and their local authorities. But it would be unsatisfactory because the enormous differences in non-domestic rateable values between authorities would create a great disparity in local tax rates, with very low domestic tax rates in authorities with the highest concentration of non-domestic rateable value. (Camden could substantially increase its spending and still not need to charge local residents anything for their services). Therefore a complicated resources equalisation scheme would be required, which would have a very similar impact on local authority finances as pooling the yield of the non-domestic rate.

1.7. We do however suggest one modification to the basic proposal. If the entire yield of the national non-domestic rate is pooled centrally there will be no link at all between the business ratepayer and the services provided by the local council. We believe it is desirable that business should have some standing to question the quality and quantity of the services provided. We also believe it is desirable for local authorities to have an incentive to encourage development.

1.8. We considered an option of allowing local authorities to retain automatically the benefit of 5 per cent of the proceeds of the national non-domestic rate. But the advantages of this in terms of retaining a link with their business ratepayers would be severely attenuated by the fact that the local authorities would have no discretion about the amount raised and there would be no locus for business consultation.

1.9. We therefore propose that local authorities should be given the power to raise a discretionary local non-domestic rate, of up to 5 per cent of the nationally set poundage. In the first year of the uniform rate, the national poundage would be set to yield 5 per cent less in real terms than the national average of the previous year. On 1984-5 illustrative numbers this would mean a national poundage of 170p. In total, local authorities covering a particular area would then have discretion to charge a local rate up to 8½p. This amount would be split between tiers of authority in the same proportion as the split of grant entitlement. Each authority would be able to levy some or all of its share of the 8½p.

1.10. Most high spending authorities would tend to levy the 5% maximum rate. But some low spending authorities, where business could face the largest poundage increases on the setting of a uniform rate, may choose to levy less than the maximum, thus reducing the number of non-domestic ratepayers losing from the setting of a uniform rate. No non-domestic ratepayer would pay more under this proposal than under the simple proposal to set the national rate at the national average.

1.11. We propose to reduce the local charge payable in the City by a variation in these arrangements. This is discussed further in Annex 2.

C. <u>HOW THE NATIONAL NON-DOMESTIC RATE WOULD WORK</u>

1.12. The features of our proposed scheme are:

(a) the proceeds of the national non-domestic rate would be hypothecated to local authority spending, the non-domestic rate would become an "assigned revenue".

(b) the poundage would be statutorily indexed to the GDP deflator forecast published in the Chancellor's Autumn Statement.

(c) the proceeds would be collected by local authorities on the basis of an assessment by central government of the product of the national poundage and rateable values frozen at a suitable point before the start of the financial year.

(d) there would be regular revaluations - or possibly a process of rolling revaluation.

1.13. These features are discussed in turn below.

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(i) <u>Hypothecation</u>

1.14. We have assumed that the non-domestic rate becomes an assigned revenue hypothecated to the support of local authority expenditure. The alternative would be simply to make the non-domestic rate part of general tax revenues, with the rate set in the Budget. In which case, to make up for the loss of revenue to local authorities, standard grant, also paid on a per adult basis, would need to be increased by the yield of the non-domestic rate, from £4.0bn to £10.5bn.

1.15. The removal of local authority discretion over the business rate will be seen as a centralising move. To go further and to remove the link between non-domestic rates and local authority spending entirely would exacerbate this. Local authorities would find it difficult to accept being tax collection agents. Indeed, if the non-domestic rate simply became part of general taxation, we believe that it would be necessary to place responsibility for collection with the Inland Revenue, a task for which they are not equipped at present and which would entail a substantial addition to civil service manpower.

(ii) <u>Statutory Indexation</u>

1.16. We have discussed with business representatives who have told us that they feel some form of statutory indexation or a statutory ceiling on the year-on-year increase in the business rate which could only be overridden by primary legislation would be a safeguard against a future government increasing business taxation through the non-domestic rate. A ceiling would place a maximum on the annual increase, but it would still necessitate a Ministerial decision every autumn on the increase in the non-domestic rate. Statutory indexation would remove the need for decisions and increase the automaticity of the local authority finance system.

1.17. There is a choice of inflation measures to be used and a choice of whether the link should be historic or forecast. The use of the historic RPI is well precedented. It is a published and well understood index and has the benefit, compared to, say, the GDP deflator of not being revised. But the RPI is a basket of consumer goods, not a measure of business, or local authority, costs. The GDP deflator is likely to be a better indicator of those. A historic rate would look out of date by the following March, if inflation were trending sharply. For that reason we provisionally suggest that the link be made to the GDP deflator forecast published in the Autumn Statement.

(iii) Collection

1.18. Local authorities' contributions to the national non-domestic rate pool would be equal to the national poundage multiplied by their rateable value frozen at an appropriate date in the previous financial year. The rateable value would be adjusted to reflect fully statutory reliefs for empty properties etc. The cost of discretionary reliefs would have to be met out of the locally variable poundage. Local authorities would continue to collect the non-domestic rate. To avoid unnecessary movement of funds, contributions to the national pool would be deducted from authorities' entitlement to grant and their share of the national pool. Net payments only would then be made to or by the authority.

1.19. This will give local authorities every incentive to maximise the collection of non-domestic rates. Every pound not collected would ultimately fall onto the local charge.

1.20. This method of collection will mean that authorities will retain the benefit of any increase in rateable value after the date on which rateable values are frozen. For most authorities this will give them some leeway in meeting their deemed contribution. But it may be unreasonable to expect an authority to meet its assessed contribution to the non-domestic rate pool, if it suffers a sharp decline in rateable value after the date on which effective rateable values are frozen. In such - comparatively rare - circumstances, the authority's contribution to the non-domestic rate pool would have to be reassessed.

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(iv) Revaluation

1.21. Ministers have already agreed that there should be a non-domestic revaluation not earlier than 1989. A revaluation will be essential if the new uniform poundage is to be levied on a fair basis. We believe that the two changes - the revaluation and the setting of a uniform rate - should be introduced at the same time. That is also the view of the CBI and the ABCC. That requires an early announcement of a non- domestic revaluation, with a view to the introduction of new rateable values in April 1989 or 1990.

1.22 The effects of a non-domestic revaluation - on the rental basis used in previous revaluations - will be to produce substantial shifts between both classes of property and regions. In some cases this will be partly offset by the move to a uniform non-domestic rate; in other cases the losses or gains from the revaluation will be reinforced by the move to a national non-domestic rate, set to maintain real yield of the non-domestic rate.

1.23 We have two sample studies, one by the Inland Revenue Valuation Office, covering all types of non-domestic properties in a sample of 19 English towns and Cardiff, and a survey by Herring Son and Daw, a leading firm of rating Surveyors, based on 11 English towns. Despite some methodological differences, both surveys show the following results:

(a) **Gainers from the revaluation**

- most industrial and warehouse properties, with the greatest gains to the largest and oldest properties

- most offices
- poorer iron and steel works, ship- shipbuilding yards, older car manufacturing plants.

(b) Losers from the revaluation -
- retail sector, particularly prime shops in central locations and hyper markets
- very modern factories and high tech units
- best oil refineries and petro-chemical complexes
- hotels, boarding houses and licensed premises.

1.24 The setting of a uniform non-domestic rate will produce shifts between low rate poundages areas and high rate poundage areas. Table 1. shows the Valuation Office's estimates of the effects of a revaluation only, and a revaluation combined with setting the non-domestic rate at the 1985-6 national average. The effects are shown first as a percentage of rates and second as a percentage of rent and rates combined. In both cases they assume that all authorities make full use of the discretionary 5 per cent local rate.

Table 1:

	REVALUATION SHIFTS		REVALUATION WITH NATIONAL NON-DOMESTIC RATE	
	As percentage of current rates	As percentage of rent and current rates	As percentage of current rates	As percentage of rent and current rates
Basingstoke	+ 31%	+ 7%	+ 47%	+ 10%
Birmingham	- 7%	- 2%	- 9%	- 3%
Brighton	+ 28%	+ 7%	+ 32%	+ 8%
Bristol	+ 16%	+ 5%	+ 1%	0
Cardiff	+ 10%	+ 3%	+ 25%	+ 6%
Coventry	- 7%	- 2%	- 13%	- 4%
Croydon	+ 2%	0	+ 27%	+ 6%
Exeter	+ 5%	+ 1%	+ 24%	+ 6%
Leeds	0	0	- 3%	- 1%
Leicester	- 2%	- 1%	+ 9%	+ 3%
Liverpool	- 25%	- 11%	- 53%	- 23%
Manchester	- 8%	- 3%	- 39%	- 15%
Newcastle	- 11%	- 5%	- 55%	- 25%
Northampton	- 2%	- 1%	+ 6%	+ 2%
Norwich	+ 3%	+ 1%	+ 7%	+ 2%
Oxford	+ 18%	+ 4%	+ 30%	+ 7%
Plymouth	+ 15%	+ 4%	+ 31%	+ 7%
Reading	+ 35%	+ 8%	+ 44%	+ 10%
Sheffield	- 8%	- 3%	- 41%	- 16%
Westminster	- 12%	- 4%	+ 5%	+ 1%

1.25 We have looked at the likely impact on the property market. Viewed nationally, increases in the retail sector should lead to decreases for most other property groups. The largest increases (over 100 per cent in some cases) in rate bills are for prime central shops and offices in the South and West. The Valuation Office and Herring and Son and Daw both point out that these sorts of properties have low rate bills in relation to their rents and tend to be held on a leasehold basis, with rents subject to quinquennial review. Taking account of rent as well, the maximum increase in occupancy costs faced on revaluation combined with setting a national non-domestic rate is under 20 per cent. Rents of properties which are likely to face the largest increases in bills are escalating and the Valuation Office judgment is that the rate increases will be relatively modest when set beside rent increases and will be assimilated in rent reviews.

1.26 The biggest gainers are industrial properties and warehouses in the North, where rate bills are currently very high relative to rents. They will gain both from the revaluation and the setting of the national rate at the national average. In many cases these properties are owner-occupied and they will directly benefit from the cut in rate bill. Over time the reduced rates liability will be reflected in an increase in the capital value of the property.

1.27 We will, nonetheless, need transitional arrangements to safety-net non-domestic ratepayers against increases in rate bills arising from both the changes. These are discussed below.

1.28. The business organisations have represented to us that they would hope to see a commitment to regular revaluations as part of any reformed regime for non-domestic rates. With complete divorce of the domestic and non-domestic tax systems, there will be no need to link a non-domestic revaluation to a similar upheaval on the domestic tax side. We would therefore propose that a commitment to regular revaluations be an integral part of the package.

1.29 The CBI have suggested a more radical option - a continual updating of the non-domestic rateable value base through a rolling revaluation". They have promised a paper setting out their proposals. We see no objection in principle to such a scheme. But since it would mean periodic actual valuations combined with indexation of the rateable value base in years between revaluations, the crucial question is whether a sensible index can be found. The preliminary Valuation Office view is that it would be difficult to find an index that would be sufficiently sensitive to movements to reduce the disruption caused by a general revaluation. To index the base to some general standard of inflation would however be an alternative to increasing the poundage between years.

TRANSITION

1.30 On the basis of 1984-5 poundages and rateable values the package will mean a substantial number of small losers and a smaller number of large gainers. But in practice, these changes are likely to be overshadowed by larger changes arising from the revaluation if - as we have suggested - new rateable values are introduced at the same time as the move to a uniform national non-domestic poundage. If we are to gain general acceptance from the business community for these changes, we shall need to phase in the net effects so that individual businesses are protected against sudden sharp increases in rate bills, which it would be difficult for them to absorb in one year. This will probably require the setting of a percentage limit on increases in non-domestic rate bills, with the costs of such relief paid for either by a corresponding limit on reductions in rate bills or by an overall adjustment to the uniform non-domestic rate poundage. Contributions by authorities to the national pool would need to be adjusted to reflect the revenue losses from this statutory relief, which would be phased out over a number of years. It would be important to announce the details of the transitional arrangments and their phasing well in advance of the introduction of the new system, to reduce uncertainty and give the property market time to adjust.

1.31 It would also be possible to shift the balance between gainers and losers by reducing the aggregate yield of the non-domestic rate. This approach has been advocated by the CBI. The following table, shows, on the basis of the 1984-5 poundages and rateable values used in the exemplifications, the changes in the non-domestic rate poundage and revenue yield which would be required to ensure more gainers than losers from the move to a uniform non-domestic rate.

(No. of hereditaments in thousands; 1984-5 notional poundages)

National poundage	Gainers	Losers	Cost of lost Yield (£m)
178.70	461.8	1,304.0	0
170.0	881.0	884.8	300
160.0	1,314.9	450.9	700
150.0	1,745.2	20.6	1100
140.0	1,765.8	0	1500

1.32 Setting the national rate at 170p would ensure a rough balance between gainers and losers so long as authorities choose not to levy the locally variable rate. But in practice many authorities will levy the maximum rate, so if we want to ensure a preponderance of gainers over losers we would need to reduce the maximum poundage (national and local) to 160p at a cost of £700m in lost revenue.

ANNEX 2

GRANT

A. INTRODUCTION

2.1 This annex describes the main features of our proposed new grant arrangements, in the light of the discussions with other departments. It covers the structure of the grant system, including the possible role of assigned revenues and the proposal by DES for an education needs element; our proposals for a new approach to assessing authorities' expenditure needs for the distribution of grant; and the future role of specific grants.

B. THE PRESENT GRANT SYSTEM

2.2 The present grant system consists of a block grant and a domestic rate relief grant. The former compensates authorities for differences in their assessed expenditure needs (GRE's) and differences in their rateable resources, thus enabling them to finance comparable levels of service for the same rate in the £. In addition to this equalisation function, block grant also provides a common £ amount per head to all authorities as across-the-board support for local government expenditure. Domestic rate relief grant provides an additional subsidy to all domestic ratepayers in the form of a uniform reduction in domestic rate poundages (currently 18½p in England and Wales).

C. STRUCTURE OF THE NEW GRANT SYSTEM

2.3 In our Specification Report to E(LF) in May we recommended a new grant system comprising just:

i. a lump sum equalising needs grant; and

ii. a standard grant.

With non-domestic rates set nationally, there will be no need - even with a locally set domestic property charge - for a mechanism to give a cash discount to domestic taxpayers.

2.4 This remains our preferred approach even if, as we now recommend, we retain a residual property charge. The only change we envisage is that the standard grant should take the form of an assigned revenue.

Needs Grant

2.5 The principle of compensating authorities for differences in their expenditure needs (as assessed by a formula) has been an important feature of the rate support grant system for many years, and well before the introduction of block grant. We propose that this principle should be retained: if it were not, tax rates in needy areas would have to be far higher to finance the necessary level of services than they would in more affluent areas. But we also believe that equalisation of spending needs can be operated much more simply and transparently than it has been in the past.

2.6 Under our proposals, the area with the lowest assessed needs per adult in the country would receive no needs grant; all other areas would receive an amount of grant equal to the difference between their assessed needs per adult and those of the authority with the lowest assessed needs per adult. The grant would be paid to all tiers of local government, ie non-metropolitan counties and districts, metropolitan districts, London boroughs, joint boards, the ILEA and the Metropolitan Police. The effect of paying needs grant in this way would be to require the same level of local charge per adult throughout the country to finance expenditure at the level of assessed expenditure needs.

2.7 Under the present system, grant allocations have been determined not only by reference to authorities' assessed needs but also (because of the way in which resources are equalised) by reference to their actual expenditure in the year. This has led to frequent adjustments of grant allocations during the year, as expenditure estimates are changed. Needs assessments have also been subject to mid-year adjustments, which have been a further cause of fluctuations in grant. Together these factors have created instability and complexity in the grant/expenditure/tax relationship, thereby increasing uncertainty for local authorities, giving confusing signals to ratepayers, and weakening local accountability.

2.8 Under the new system, we would therefore propose that grant allocations should be determined as a lump sum before the start of the year on the basis of the needs assessment formula alone and that they should not be affected in any way by what authorities actually spend. We also propose that mid-year adjustments to needs assessments should not be made except in the most exceptional circumstances (eg serious data errors); wherever possible, if adjustments are considered essential, they should be made to the assessments for the following year.

Standard Grant

2.9 The proposals we put forward in May envisaged that the Government would decide every year the total amount of grant which should be available to support local government expenditure. The needs equalisation grant would be the first call on this account. The residue would be distributed as a standard amount per adult head of population to all authorities, thereby producing a uniform reduction in the amount needed to be raised through the local charge across the country, in the same (but at present completely obscure) way in which the block grant provides such support. Like the needs grant, the standard grant would be paid to all tiers of local government.

2.10 In addition, though not part of the grant system, the national non-domestic rate pool would be distributed to local authorities on the same basis as standard grant - ie as a common amount per adult head of population to all authorities, thus further reducing by a common amount across the country the amount needed to be raised through the local charge.

Assigned Revenues

2.11 In the course of our further development work since May, we have concluded that the increased pressure on local authority spending which the new system will automatically provide gives us the opportunity to make a further significant shift away from a centralist approach. We propose that the standard grant should be calculated as a guaranteed share of a national tax - an assigned revenue.

2.12 The advantages of this would be:

i. it would increase the automaticity of the grant system and give authorities a guaranteed income which was independent of government decisions. This could be presentationally important as part of a localist package, particularly when we are nationalising the non-domestic rate;

ii. it would make it much more difficult for local authorities to blame central Government for changes in their local tax bills;

iii. it would help make local taxpayers much more aware of the true cost of local services, if part of the national tax they pay was clearly earmarked for the support of local expenditure;

iv. the argument about the regressiveness or otherwise of local tax arrangements could be set in the wider context of the national taxation system.

2.13 This proposal would entail no increase in national taxation; assigning a proportion of a national tax to local government would be simply a way of financing the standard grant.

2.14 As to which tax might be assigned to local government, we believe VAT looks the most promising candidate. On the basis of the current average yield, either 25% of the total yield or 4 percentage points should be sufficient to finance standard grant of £4bn*.

D. NEW GRANT SYSTEM IN OPERATION

2.15 The individual authority under the new system will receive "non-local" income of three types: the lump sum needs grant (the amount of which will vary according to its assessed needs); the assigned revenue/standard grant (which will be the same amount per adult for all authorities) and the national non-domestic rate pool (also the same amount per adult for all authorities). This will leave authorities with the same local charge per adult to raise in order to finance their own assessed needs.

2.16 Because all non-local sources of income are fixed at the start of the year and do not vary subsequently, the full effect of any variations in an authority's spending from its assessed need are reflected, £ for £, in the level of its local charge. For example, if an authority spends £25 per adult below its assessed need it can reduce its local charge by £25; conversely if it spends £25 per adult above its assessed need, the local charge must rise by £25.

* There are no "England only" yields of VAT. We have assumed that the English yield of VAT is 80 percent of the UK yield. Insofar as this is an underestimate, the required percentages will be lower.

2.17 Under this arrangement, accountability is considerably enhanced: the relationship between expenditure and local taxation is very clear and the full cost of expenditure above assessed need is borne by residents, who also reap the full benefit of any expenditure reductions below the level of assessed need.

E. NEEDS ASSESSMENT

2.18 Together with the reform of the grant structure, we proposed to E(LF) in May the development of a new method of assessing the expenditure needs of local authorities. Our starting point was the complexity and incomprehensibility of the current GRE methodology and doubts as to whether the present system adequately reflects extremes of local need in some inner city areas.

2.19 In devising a new method of needs assessment, reconciling the objective of greater simplicity with greater sensitivity to extremes of complex local needs will not be easy. It is a task which will take some time and at this stage we cannot be certain of the results. However, we believe that a basis for starting development work exists.

2.20 The present GRE system tries to do too much. It purports to measure for a large number of widely differing authorities variations in the cost of providing every single local authority service, from the "core" services such as education, police, fire and road maintenance down to cemeteries, crematoria, school crossing patrols and allotments. Many of the GREs for these minor services however are not performing any significant redistributive role. We therefore propose that we concentrate our efforts on improving and wherever possible simplifying the needs assessments of the "core" services and consigning the rest to a single "other services" block which would be allocated according to a simple formula - probably per head of population. This would be consistent with the freedom of local authorities to set priorities between services.

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2.21 For the "core" services our starting point is likely to be the number of clients or units towards which the service is directed, such as school children or road miles, which would be multiplied by an average unit cost of provision to give the assessed need for the service. However, as with the present system, some account will probably need to be taken of factors outside the control of local authorities which cause the cost of providing the service (eg sparsity or density of population) to vary between areas. The intention would be to use only a small number of cost indicators and to make any cost compensation more explicit. Capital expenditure would continue to be included in the needs assessments; the method used would have to be compatible with the new system of capital expenditure control.

2.22 For some services, like education and personal social services, the demands falling on local authorities will also reflect the level of social deprivation in the area. For example, in inner cities, a higher proportion of school pupils will be in need of special educational help because of their deprived backgrounds. Any system of needs assessment which aims to be sensitive to the extremes of local need must take some account of this. The present system of GREs uses a number of composite indicators of deprivation which have been developed for particular services. Our aim would be to try to develop one composite multiple deprivation indicator to apply to all the main services. This might consist of say half a dozen factors (eg people with low incomes, unemployment, poor housing, members of ethnic minorities, single parent families) which together could reflect the "social need" component of all the core services and also the entire demand for personal social services. If a satisfactory indicator could be developed it would considerably simplify the overall needs assessment formula, since it could then consist simply of client group or service unit numbers; a per capita component for the "other services" block; a few cost factors; and a multiple deprivation indicator.

2.23 This approach does however, have certain consequences and implications:

i. there would no longer be "self-contained" assessments of expenditure need for individual services, as there are at present. We do not regard this as a problem, but some departments responsible for individual local government services may have reservations. We would have to consider how to allocate the needs assessments between tiers, and to joint boards;

ii. compiling a multiple deprivation indicator will require a combination of research, statistical analysis and most importantly Ministerial judgement to decide what components should go into it and what weight they should be given. We would need to avoid creating a 'black box', the results from which could not be explained;

iii. the multiple deprivation indicator would assume a powerful redistributive force in terms of needs assessment and grant, thus making very visible the role of Ministerial judgements and decisions in determining the balance of the grant distribution;

iv. it is likely to reverse the trend of the past five years of shifting grant away from the urban areas towards the shire areas. This is, however, unavoidable if we are to devise a system which is more sensitive to extremes of local need; and under a system where the full cost of expenditure above assessed needs is borne entirely by residents through the local charge, the consequences for those tax-payers of understating expenditure needs will be dire indeed.

We therefore recommend that we start work in conjunction with other departments developing and testing the approach outlined above.

F. POSSIBLE MODIFICATIONS TO GRANT PROPOSALS

(i) An education needs grant

2.24 The Department of Education and Science have suggested:

(i) assessing and paying separately the education component of the needs grant on the basis of a separate needs assessment for education expenditure;

(ii) making the Secretary of State for Education and Science responsible for setting the grant and accountable for it to Parliament;

(iii) giving the Secretary of State for Education and Science a general power to pay specific grants in support of central government policies and initiatives in the education field.

2.25 DES argue that this arrangement would bring greater clarity to the relationship between their Secretary of State and local education authorities. He would be better able to bring about the delivery of nationally agreed education policies and priorities for what is essentially a national service, while authorities would more easily perceive the relationship between those policies and priorities and the Government's assessment of their education expenditure needs, currently subsumed within the overall block grant distribution.

2.26 While we see the force of these arguments from the viewpoint of DES, we have serious reservations about their wider implications. Education is the largest component of local authority expenditure and if a corresponding share of the needs grant were pre-empted for education, it seems likely that a number of other Departments would want to protect spending on the services for which they are responsible by securing their "own" needs grant distributed on the basis of needs assessments for their own services. The needs assessments for individual services would assume an increasingly normative role and we would move towards a de facto regime of specific grants, under which authorities would have limited freedom to determine priorities between services.

2.27 This would be incompatible with the approach of increasing local accountability which lies at the heart of our proposals and would be fiercely resisted by local government. At local authority level it would encourage service chief officers to believe they had a right to a given share (or quite probably more than a given share) of the local authority's budget, which in turn would discourage cross-service assessment of priorities and reduce the chance of a sensible allocation of resources which will address local needs in the most cost effective way. We would therefore not endorse the proposal for a separate education needs grant. The question of specific grants is addressed in section G (paragraphs 2.35 - 2.37).

(ii) Resources equalisation

2.28 Resources equalisation is the most complex part of the present grant system. If we were simply to set the non-domestic rate nationally, redistributing the yield on a simple per adult basis, and to replace rateable value wholly by a residents' charge (leaving all authorities with the same taxable capacity per head of adult population) there would be no case for a resources equalisation grant. However if, as we now recommend, the new system involves retaining a property tax element, the case for resources equalisation needs to be considered.

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2.29 At present, resources equalisation rests on the assumption that domestic rateable values represent a reasonable measure of taxable capacity both within and between areas. On this basis, it has been seen as right in principle to equalise resources so that taxpayers in all areas pay a common rate poundage (rather than rate bill) for a given level of expenditure. This is achieved by paying a deficiency grant to areas with low domestic rateable resources at the expense of apparently wealthier areas. However, the variations in rate bills from one area to another which result from equal poundages far exceed variations in people's income. Indeed, equalisation through the grant system actually accentuates differences in rate bills between areas. For this reason, even if the method of assessing rateable value were to remain unchanged, we believe that rate poundage equalisation through the grant system should be abandoned.

2.30 The same arguments against resource equalisation would apply a fortiori if there were a switch to capital values as the valuation base. Capital-based rateable values would continue to exaggerate influences in ability to pay between areas, perhaps even more than the existing rental based rateable values. However, if rateable values were to be based upon floor space, the arguments against resource equalisation become rather different. The retention of a property element in the proposed local charge is designed partly to moderate changes in the distribution of the domestic tax burden within areas, and partly to recognise that some local authority services are provided to property. Any attempt to equalise floor space per adult between areas would result in an unequal level of local charge - expressed as a cost per adult - for a standard level of service across the country, which it would be difficult to justify in terms of the new system. Moreover, floor space is primarily a measure of the relative consumption of property related services within an area. It is not a measure of relative taxable resources between areas.

2.31 On balance therefore we conclude that even with a retained property element we should not provide a grant to equalise resources.

(iii) London arrangements

2.32 Under the present system, there are arrangements which allow London to keep some of the benefit from its high rateable resources and so enable domestic rate bills throughout London to be lower than they would otherwise be. There is no justification of principle for such arrangements under the new system. We do not therefore favour retaining special London arrangements except as a last resort method of limiting the burden on local taxpayers in London if, for some reason, London's needs assessments were thought to be deficient.

2.33 Although we see no general case for London arrangements, we do envisage that special treatment will be needed for the City of London, which is unique both in its electoral system and in the fact that almost all of its services are provided for non-domestic ratepayers. It would be unfair on the City's small number of residents to have to shoulder a massively increased burden; and unrealistic to assume that any general system of needs assessment will be able to take account of the City's unique position.

2.34 We are already proposing that authorities should have the power to raise a discretionary non-domestic rate of up to 5% of the nationally set poundage (split between tiers). The City would have its share of this 5%. In addition we propose that a further 5% of non- domestic rate income should be available to the City solely for its own use. This would mean that the national non-domestic rate in the City would be 5% lower than elsewhere.

G. SPECIFIC GRANTS

2.35 In the Main Report we reject an increase in specific grants as a way of reducing the size of the residents' charge. Extensive use of specific grants would run counter to the system we seek based on local accountability and choice. We recognise, however, that a case can be made out for specific grants to promote central government initiatives and priorities. The Secretary of State for Education and Science believes that he needs a general power to make specific grants for reasons of this type, in areas where experience has shown that policies cannot otherwise be delivered.

2.36 It is far from clear that the existing pattern of specific grants can be justified in these terms. It appears to follow no consistent set of principles or objectives. Many of the grants are very small (ie smallholdings: £200,000; clean air: £1.3m) and some derive from previous policy objectives which have long since been achieved or else modified. The justification for some of the others is either unclear or could equally well apply to areas where there are no specific grants.

2.37 We therefore propose that there should be a proper review of the role of specific grants in the new system and that a coherent set of principles be drawn up for deciding what types of expenditure should in future be supported by specific grants.

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ANNEX 3

AN EXTENDED CITY GRANT

A. INTRODUCTION

3.1 In our May Specification Report we recommend consideration of a special City Grant to target aid to inner city areas on two quite separate, though not mutually exclusive, counts:

i. to make good the extent to which our new method of needs assessment might fail to pick up the worst extremes of need in inner city areas;

ii. to give central government a means of direct intervention in the way in which selected inner city authorities provided and operated their mainstream services.

3.2 In terms of (i) above, considered in isolation, city grant should be considered only as a last resort in the event of failure to develop a method of needs assessment more sensitive to extremes of local need. In these circumstances we would envisage an unhypothecated 'top up', amounting to, say, 5 per cent of the budgets of the authorities concerned, paid to a small number of inner city authorities. The purpose would simply be to reduce the local tax bill which certain high spending urban authorities might otherwise have to impose on their residents.

3.3 The bottom-up pressures of the new system will, however, take a considerable time to rein back the extravagant spending policies of certain inner city authorities. It can be argued that a more interventionist financial regime would be more effective. This Annex considers the case for an interventionist city grant regime, sets out a possible specification, and examines the implications.

It would replace a significant proportion of the lump sum needs grant the inner cities would otherwise receive, rather than merely supplement it.

B. THE CASE FOR AN INTERVENTIONIST CITY GRANT

3.4 The justification for a large scale city grant of this kind would be that, both because of the scale of their needs and because of the heavy reliance of their population on social benefits, the proportion of local authority expenditure in the inner cities met by the Exchequer is always likely to be so high that financing decisions should not be treated as a purely local issue. Furthermore there is a national interest in avoiding intolerably high local tax bills for residents in these areas, which in turn would provoke further emigration and even greater difficulties in revenue raising.

3.5 In such circumstances it could be argued that substantial taxpayer support for local spending should be matched by a degree of central intervention in local spending policies to ensure that the money was used productively. Central government would become expressly 'accountable' for the use of funds it provided.

3.6 Allied with Widdicombe institutional reforms a large scale City grant could provide the lever to change the balance of power in the inner cities and start to overcome the endemic problems of poor management and social decline. It would provide an opportunity for the Government to tackle directly the problems of securing the efficient and cost-effective delivery of main services in the inner cities which some at least of the authorities have conspicuously failed to achieve.

3.7 This approach would also avoid the need deliberately to complicate needs assessment methodologies to cope with the present peaks of need evident in inner city areas.

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C. SPECIFICATION OF AN INTERVENTIONIST CITY GRANT

3.8 On the "interventionist" model of a city grant, the new grant would have to have two characteristics in particular:

i. it would have to be large in order to give the Government effective leverage over local authority services; we could be talking of a city grant additional to normal grant entitlement meeting up to 20% of authorities' budgets;

ii. the Government would have to be able to attach strings to the grant on offer, e.g. the rationalisation or reorganisation of a service; a reduction in the number of employees; or a more vigorous charging policy.

3.9 Between 10 and 15 authorities would be selected. Central Government would then negotiate with the selected authorities.

i. how much additional expenditure was needed over and above assessed needs to improve main programmes;

ii. the size of the city grant contribution to such expenditure;

iii. the changes in policy/practice/organisation which the authorities would be expected to make in return for the extra money.

3.10 Provided the authorities concerned agreed to commit themselves by means of a detailed work programme to substantive improvements in the efficiency and effectiveness of local service provision, then central government would release substantive extra resources to finance both existing main programme expenditure and new projects. If an authority refused this offer, then they would have to rely on needs grant, standard grant, their allocation of the nationalised non-domestic rate, and a substantially higher than otherwise local charge.

3.11 There would have to be follow-up arrangements to see that the pre-conditions were met, and sanctions in the event of failure to meet them.

D. DISADVANTAGES

3.12 It would no doubt be argued that this proposal runs directly counter to our "localist" approach and proof that we did not believe our own rhetoric about local accountability. The counter argument would be that the City grant approach was needed only in a few authorities which would, under any local government finance system, require huge injections of central funds. To hand over funds with no strings attached, in the name of "localism" would not enhance accountability, but blur it.

3.13 If we did decide to opt for large scale intervention we would need to overcome the following formidable practical difficulties:

i. How would we decide which authorities to select? The urban programme selection procedure might help here: but there would be ample scope for argument about "borderline" authorities who felt the need asssessment formula did not adequately reflect their needs;

iii. would Whitehall civil servants be competent to involve themselves in the details of the running operations of local authorities and the selection of programmes to attract grant aid? Will Whitehall ever know - or be perceived to know - enough about local problems to challenge authorititively and successfully councillors' judgements on the needs of their areas?

iv. is there any guarantee that authorities concerned will accept the offer and thereby forgo the opportunity to martyr themselves in the name of "local democratic freedoms"?

v. how realistic is it to suppose that we could effect a transformation in the policies and performance of the authorities? There are fundamental irreconcilable differences of policy between left-wing Labour authorities and the Government on e.g. subsidies to the housing revenue account. And even where this is not the case (e.g. refuse collection), effective management may be hamstrung by the unions.

E. CONCLUSION

3.14 Whether or not we need a city grant to avoid an excessive local tax burden in the inner cities depends upon how successful we are in developing a new method of needs assessment which is sensitive to extremes of local need. If a city grant is seen only as a "top up" to compensate for inadequacies in the needs assessment then our preference would be to put more effort into improving the needs assessment rather than having to set up a new specific grant apparatus.

3.15 If, however, we see city grant as an opportunity for central Government to intervene in the management of the worst inner city areas where ineffective and ideologically hidebound local authorities have failed then we must consider the merits of the city grant proposal in that light. The political and practical difficulties of an extended city grant are in our view so formidable that it should only be contemplated if we were satisfied that the problems of mismanagement in a small minority of authorities were so serious that we could not wait for the pressures of local accountability to take their effect. We are not yet so convinced.

ANNEX 4

THE LOCAL CHARGE

A. INTRODUCTION

4.1 In the Main Report we described our proposal to combine the flat-rate residents' charge with a property charge element, replacing domestic rates with a new local charge. This annex describes the elements of the local charge and the way it would operate. Annex 5 describes the way in which the burden of the charge could be reduced for those on low incomes, who could not be expected to bear the full cost of the local charge.

4.2 Under the local charge proposal, the flat-rate residents' charge would raise 70 per cent and the property charge would raise 30 per cent of domestic tax revenue in each authority. This reflects the notional split between local authority services which benefit people only and those which benefit both property and people.

4.3 The residents' charge would be payable by every adult whose main or only residence was in the local authority area. (This is discussed further in Section D below). The property charge would be payable by householders or owners of property.

B. THE PROPERTY CHARGE

4.4. The property element in the local charge would recognise

(a) that some local authority services benefit predominantly "property" rather than "people" and hence it is logical to base some element of the local charge on it;

(b) that size or value of property occupied bears some relationship to "ability to pay". Taking account of property in calculating local tax liability will enhance the perceived "fairness" of the new charge.

The implications of the proposal for the progressivity of the charge on different classes of household are discussed in Annex 7.

4.5. If property is to be a permanent feature of the new local tax system, it would be impossible to persist on a long-term basis with existing rental values which are already 12 years out of date and which cannot be updated. A new valuation base will be needed. The front-runners are:

(a) capital values;

(b) floor space.

4.6. There is ample evidence on which to base a capital valuation. The Valuation Office would, in effect, assign a price to every dwelling in the country. This could be blurred by banding or "unitising" ie converting the capital value bands into a number of units according to a specified schedule. Regular revaluations would be required once the new tax base was introduced to keep it up to date. Measures could be taken to minimise the likelihood of shifts of value on a revaluation - by, for instance, indexing the base to changes in property prices. But there would always be some disruption entailed in any revaluation.

4.7. The alternative is to base the property charge on the floor space of domestic properties. The strength of this system is that floor space, once measured, varies only incrementally. There would be no need for general revaluations with the associated disruption. Once the ground rules for measurement are established, it is also difficult to dispute a physical measurement in the way that valuations which contain elements of judgement can be challenged. The cost of the present appeals system could therefore be reduced.

4.8. Floor space is also arguably a better measure of the relative consumption of property related services than capital values which will vary strongly between equivalent sized houses according to location and other market factors.

4.9. The absence of such market factors from floor space valuations means that it would be less good than capital values as a reflection of ability to pay, though better-off households are likely to pay more with a property charge included in the local charge, than with a simple flat-rate residents' charge.

4.10. Public perception of the changes we propose will also be conditioned largely by comparison with the present system based on rates alone. It is difficult to generalise but a move to a property tax which pays no regard to market valuations is likely to be more disruptive to household tax burdens than a move to capital values.

4.11. There is a variation on a pure floor space model which might prove less disruptive - a points system. Although the major determinant of the property's value would still be the property's floor space, this method could also take account of, for example, the type of property. A detached house would have a higher points score than, say, a semi-detached or terraced house with the same floor space. Additional points could be given for certain features of the property eg garage space and central heating. This would be likely to create a closer fit with the capital value of the property, and reflect better "ability to pay" but would, like floor space, never require a general revaluation.

4.12. In the new system the property charge will bear a much smaller weight than domestic rates do under the present system. That points to a simple and easily administered base for the property charge, which suggests floor space as the preferable option. For the reasons set out in Annex 2, there would be no equalisation of domestic taxable resources between areas through the grant system. The valuation base for the property charge therefore has no implications for grant or the distribution of relative tax burdens between areas - only for the distribution of domestic tax burdens within an area.

C. THE BALANCE BETWEEN THE PROPERTY AND RESIDENTS' CHARGE

4.13. In the Main Report we propose a mixed tax, with the residents' charge raising 70 per cent of local revenue and the property charge raising 30 per cent. Other permutations are possible:

(a) property charge for lower tier authorities; residents' charge for upper tier authorities;

(b) property charge to finance spending up to assessed need; residents' charge to finance spending in excess of assessed need.

4.14. Our preference is for a scheme where all authorities would levy both the property and residents' charges, and the new tax would cover all local authority spending. In order to prevent a local authority putting the whole weight of local taxation on either the property or the residents' charge, we have concluded that central government would need to specify a ratio of the two charges to be applied to all authorities. Authorities would be required to raise their domestic tax revenue in the prescribed ratio.

4.15. In the exemplifications we have illustrated a split of 70 per cent to 30 per cent based on the division between services which predominantly benefit people and services which predominantly benefit property. This approach fits best with floor space as the property tax base.

4.16. Alternative splits could be justified eg:

(i) a split between "beneficial" services (about 40 per cent) which should be charged for on the flat-rate people element and "redistributive" services (60 per cent) to be financed through the more progressive element ie the property tax. This fits better with a capital value basis for the property tax;

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(ii) a straightforward 50/50 split, as an arbitrary compromise between the two approaches.

4.17 The split chosen will, like the choice of valuation base, affect only the distribution of the tax bill within an authority not between authorities.

D. THE RESIDENTS' CHARGE

4.18 In the new system the flat-rate residents' charge would bear the major weight of local taxation. The property charge will be administered as domestic rates are now. No new issues arise. But there are no precedents for a flat-rate direct tax payable by all adults simply by virtue of their residence. This section looks at the administration of the residents' charge.

(i) Liability to pay

4.19. Our starting point is that all adults (ie those over 18 who have completed full time schooling) should be liable to register in and pay a residents' charge to the authority where they have their "main or only residence".

4.20. The "main or only residence" test is well established in assessing eligibility for mortgage interest tax relief - currently applied to 7 million households. The definition may need some expansion to meet the new circumstances. But the principle is that liability should arise in one authority only and the choice of authority would not be at the discretion of the individual taxpayer.

4.21. One of the main objectives of a residents' charge is to make as many electors as possible aware of the cost of their local services. Ideally separate bills should be sent to each liable adult, so that they are directly aware of their liability. More than one bill may however go in one envelope. The householder's bill would also include the property charge payable on the property he or she was occupying.

4.22. A different issue arises, however, where the question is who should be legally liable to pay a bill. Or, in the case of a failure to pay, who should be prosecuted. In principle each individual should be liable to pay their own residents' charge. However, in practice it is difficult to proceed against those who have no independent source of income. This situation will arise most frequently with married couples. To cope with these cases we propose to make husbands and wives jointly and severally liable for payment of the residents' charge. This is precedented.

4.23. There is no such precedent, however, for treating the much smaller number of unmarried couples in the same way in tax law. We propose that they should remain individually liable.

4.24. Where the unmarried couple concerned are dependant on state benefit to meet the rebated element of their charges, benefits will be jointly assessed and paid to one partner. It would not be possible to have different rules as to liability for unmarried couples in these circumstances. But it will be possible for the DHSS to use their existing powers to make direct payments to the local authority in cases of difficulty.

4.25. There are some groups of people and some properties which do not fit neatly into these arrangements; for these we will need special arrangements.

(a) Mobile groups and residents of institutions

4.26. A small proportion of the population - 3% - either are relatively mobile, live in Crown property or are in institutions. These groups should make some contribution to the cost of local services. At present they mostly live in accommodation which is treated as non-domestic or which is Crown property for which payment in lieu of rates is made. If these properties continue to be taxed as non-domestic, the rate payments will form part of the national pool and those living in such

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institutions will be making no direct contribution to local services. Seeking individual residents' charge payments, however, from those who occupy this accommodation could only be enforced at disproportionate cost.

4.27. We propose, therefore, that for this small section of the population a collective charge should be raised from the proprietor of the accommodation - the landlord, institution or relevant government department. They will pay the collective residents' charge in addition to the property charge payable on the property. The cost will be passed on, where appropriate, to those living in the institution. The marginal loss in accountability will be more than offset by gains in efficiency and cost effectiveness in the operation of the residents' charge.

4.28. In deciding whether to levy a collective charge or individual charges, the local authority would be making a similar decision to the one made now on whether to rate a property as separate hereditaments or as one hereditament. In some cases the choice will be one of convenience. At the borderline some right of appeal may be necessary.

4.29. Hotels and boarding houses present particular problems. In some ways they are similar to other types of accommodation providing for those who stay for relatively short periods in an area, indeed some hotels can provide long stay residential accommodation. One approach, therefore, would be to apply the collective residents' charge to hotels and boarding houses and remove them from the ambit of non-domestic rates.

4.30. That approach would, however, imply significant changes in the tax burden on hotels with large windfall gains for high value property in central locations and significant increases in tax burden for those lower down the market.

4.31. Alternatively if hotels are to continue to pay non-domestic rates, rather than a collective residents' charge, a demarcation has to be made between hotels generally catering for casual accommodation and other institutions providing longer term accomodation which may or may not choose to call themselves 'hotels'. A test based on whether the accommodation is occupied to a substantial extent as a main or only residence might be operable. Further work will be required.

4.32. At present one effect of resource equalisation is that authorities with large numbers of visitors receive no direct benefit from the rate income from hotels. Under our proposals, if hotels continue to be rated, authorities would benefit to the extent of 5% of the rate yield. This will go some way to assist authorities with the additional costs arising from large numbers of visitors. It would be possible to go further and allow retention of some of the proceeds of the national non-domestic rate derived from hotels. The greater the retention, however, the more the disparities in this part of rateable value will need to be taken into account in grant entitlement, if higher spending authorities are not to be given an unreasonable advantage. These 'equalisation' problems would arise also if authorities were allowed the full proceeds of a collective residents' charge on hotels.

(b) Students

4.33. The problem with students is that in many cases they have two "main residences" - a term-time residence and a vacation residence. We propose that for the purpose of the residents' charge they should be liable at their term-time address. This fits with the current treatment of students for RSG purposes.

4.34. Students will generally be treated in the same way as other people for the residents' charge; with their liability depending on where they live:

(a) halls of residence: will be charged the collective residents' charge and a property charge in place of non-domestic rates; this will be passed on in hall fees;

(b) bedsitters in multi-occupied houses: the landlord will pay the property charge and the collective residents' charge and pass it on in rents;

(c) private houses: the student householder will be liable for the property charge and the residents' charge;

(d) students living at home will be liable for the residents' charge.

We will need to consider the implications of this for student grant arrangements.

(c) Second homes

4.35. The definition of residence adopted for establishing liability to the residents' charge would mean that second home owners were liable only for the property charge - effectively cutting the owners' bill by two thirds. We believe that in the case of a second home the owner should be liable for a single residents' charge on top of the property charge.

4.36. Second home owners will no doubt argue that they cannot be consuming services in two areas at once, and that if the underlying philosophy is one of charging for services rendered, they should not pay the charge on a second home. But at present second home owners pay rates on both residences. Charging only a single residents' charge on a second home irrespective of the number of residents will give second home owners an effective one third discount on present bills, reflecting the lesser use of services.

(ii) Registration

4.37. A viable residents' charge will depend on an effective registration scheme. Informal discussions with local government registration officers suggest that they are generally confident of being able to build on their experience of electoral registration to produce an acceptable list. In some authorities the task will be easier than in others.

4.38. Present evidence is that electoral rolls are 93% accurate at the time of compilation. The OPCS advised that with some increase in resources the list could approach the 99% accuracy of the census. The electoral register currently costs £23m to prepare. The OPCS estimated that £30m would be needed for the improved level of reliability they thought possible but this would be for a census-style canvass without the enforcement problems entailed in compiling a tax register. Offsetting that, the proposal to rely on collective residents' charges to deal with difficult cases should be especially helpful in overcoming some shortcomings in the present registers which are most inaccurate for the young and those living in inner cities.

4.39. Unlike electoral registration there will be a positive incentive to avoid registration for the residents' charge. Greater reliance will be necessary, therefore, on penal sanctions. (Existing powers to fine those who fail to register for electoral purposes carry maximum penalties of £200 but are seldom - if ever - used). We propose two complementary duties: one on the head of the household, or, where appropriate, the landlord to register all those in a house who are liable; and a second on each individual to take reasonable steps to ensure that he or she is registered. To assist with this, we propose that the register be made public and open to inspection - as the electoral roll is. The question of enforcement is discussed further below.

4.40. A principal duty on the householder, or landlord, is the most efficient way to ensure a satisfactory canvass of all those liable to be on the roll. The separate duty on individuals is necessary to deal with those cases where an individual might connive at avoiding registration or attempt to prevent the head of the household from registering him.

4.41. Where a collective residents' charge is imposed the local authority would only need to keep a list of the properties concerned. The proprietor should, however, be required to keep a register of those residing in his accommodation at any time.

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4.42. The electoral register and the residents' charge register will overlap but will differ significantly in their coverage. The electoral register:

- excludes foreigners and others not eligible to vote;
- includes those eligible to vote but still at school;
- includes those living in accommodation at the qualifying date which is covered by a collective residents' charge;
- includes those, like students whose main residence is elsewhere but who are entitled to register to vote in more than one place.

The overlap between the two lists will be substantial but there will be significant differences - which will vary in importance from area to area. It would of course be possible to produce a single sheet of paper with names and addresses attached which is annotated to show the different status of the individuals concerned in the electoral and residence terms. But that would be one piece of paper with two lists on it and not a single list.

4.43. We also propose that the residents' charge register should be a rolling one as the present rating lists are. New residents will be expected to register on arrival in an authority and departing residents will be able to inform the local authority in order to cancel their liability to further payments, or receive refunds in appropriate circumstances. This is what householders do already for rates liability and will continue to do for the property charge. The electoral register in contrast operates on a fixed qualifying date and is updated once a year.

4.44. A rolling register will offer important advantages in the enforcement of the residents' charge. Those leaving an area will have every incentive to inform the local authority to cancel any further liability. The authority will therefore be alerted to a change of occupation and will then establish the name of the new occupier of the premises and be able to enquire about the names of other residents. In addition, authorities will be able to establish co-operative arrangements whereby an exporting authority can notify an importing authority of the arrival of a new household. A rolling system will also avoid complicating the administration of housing benefit - the local authority will pay benefit on its charge only. This is, of course, what happens with rates now.

4.45. Even if we were to forego the advantages of a rolling register in favour of a fixed qualifying date, the date specified for electoral registration - 10 October - would be too soon before the start of the financial year to which the register would relate. The numbers of people who would have to be tracked down, having left the authority before the start of the financial year, would be too great. A 1 January date - 3 months before the start of the financial year - might be more acceptable but would be too late for electoral registration purposes since time has to be allowed for an appeal procedure to operate in time for the new list to come into operation for elections in the following February. Disputes about the residents' charge register can be settled well after the register has been compiled.

4.46. The main criticism of separate registers is the extra cost incurred by having two annual canvasses of the population for information which in many cases will be identical. Certainly there would be additional costs. They would not be double the £23m cost of the electoral register because many of the fixed costs would only have to be incurred once. But, given that many of the most mobile groups are likely to be covered by the collective residents' charge and that there will be a powerful incentive on individuals to notify the council if they are moving out of the borough, it may be an option - certainly in a large number of authorities - not to have an annual canvass for the

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residents' charge. Other updating stategies may well be as effective and more cost effective.

4.47. For all these reasons we believe that we should not attempt to merge the operation of the electoral register with the preparation and maintenance of the residents' charge register. Apart from the administrative advantages outlined, this has the very important political advantage of cutting away the ground from those who would wish to argue that we were proposing to tax votes. The argument is specious but it is likely to be telling.

(iii) Enforcement

4.48. There are two enforcement issues: failure to register which applies only to the residents' charge and failure to pay, which applies both to the residents' charge and the property charge, and raises the same issues as failure to pay rates. If the residents' charge element of the new charge is not to become a voluntary tax we need effective sanctions against those who fail to register and for them to face a reasonable risk of being discovered.

4.49 Authorities will not start with a blank sheet of paper. The list for the property charge will give information about the occupiers or owners of property in their area. These are the people on whom the principal duty to register will be placed. There is also the electoral registration list, as well as benefit claims and their own housing management information. Authorities will also be able to develop strategies for checking on registration at the point of service provision eg libraries, school registrations, applications for planning permission and local searches where houses change hands. In addition, where services are charged for, particularly recreation, it will be possible to encourage registration through pricing policies which offer dual tariffs for resident and non-resident users of the facilities.

4.50. We do not propose that individuals should be required to carry proof of registration. That would be seen as the first step to a system of national identity cards. On the other hand, people will have to come to accept that when they seek a service from their local authority, the authority will be entitled to make reasonable enquiries about their entitlement to those services.

4.51. Special arrangements will be required for those living in accommodation subject to collective residents' charges. If the local authority does not retain a register of those living in that accommodation, it may be necessary for them to offer a facility whereby an individual wishing to use local authority services could be given a receipt or other documentary proof of his residence after enquiries by the local authority to the proprietor of his accommodation.

4.52. Effective enforcement will require the development of close working relations between tiers if, for example, shire districts are to receive information held by shire counties as education authorities.

E. TRANSITION

4.53. We propose a two-stage transition to the new local charge system. In the first year of the new system, the residents' charge will meet 50 per cent of the local tax bill and domestic rates, on the existing rental basis, will meet the other 50 per cent. In the second year the property element would be reduced to 40 per cent. This will mean that:

- the residents' charge will be introduced at lower levels than will subsequently be required;

- authorities will face additional constraints during the transitional period on the extent to which they will be able to finance additional expenditure by further increasing the residents charge;

- authorities will have a two year period in which to overcome any problems in running the residents' charge before it has to bear the weight of generating 70% of local revenue.

4.54. In paragraph 4.5 we argued that ultimately a new value basis should be established for the property charge. We do not propose that new basis should be introduced in the first year of the new system since there will be an important gain to be made by ensuring that all ratepayers notice an initial reduction in their rates bill to offset the new residents' charge. Moreover, by the third year of operation of the new system, when the property charge is only bearing 30 per cent of local taxation, it will be possible to introduce the new valuation base with less disruption than at the outset.

F. CONCLUSIONS

4.55. This Annex has described our proposals for a local charge with the following features:

(a) a flat-rate residents' charge to meet 70 per cent of the local tax bill; all adults to be individually liable in their main or sole place of residence;

(b) a property charge to meet 30 per cent of the local tax bill;

(c) a collective charge on communal residences;

(d) a property charge and single residents' charge on second homes;

(e) a rolling register for the residents' charge, separate from the electoral register;

(f) enforcement by local authorities using information available to them.

4.56. The costs of running the local charge will be greater than the cost of administering a flat-rate residents' charge or domestic rates. Authorities will need to maintain both 'rating records' and a residents' charge register. Before it is possible to explore with practitioners the mechanics of registration billing and collection it is not possible to reach an informed view on costs. Some additional costs will also flow from the proposal in the social security review that all local taxpayers should meet at least 20% of their local bill. Depending on the valuation base chosen there may be offsetting savings from the cost of maintaining and revaluing the tax base.

ANNEX 5

HELP FOR THOSE WITH LOW INCOMES

A. INTRODUCTION

5.1 Annex 4 sets out our basic proposal for the local charge, consisting of a residents' charge payable by all adult residents and a property charge payable by householders. The average property charge will be about £91 per household and the average residents' charge will be £106.

5.2 These bills would be too high to expect those on low incomes to pay without assistance. This Annex looks at two ways of providing assistance to the poor: first by replacing the local charge with a graduated residents' charge, and second through a rebate scheme.

B. A GRADUATED RESIDENTS' CHARGE

5.3 A graduated residents' charge would take explicit account of "ability to pay" and hence reduce the need to ally the new local tax system with a rebate scheme. We looked at the option of a banded flat-rate charge where there would be two lower rate bands. The lowest band would correspond to the maximum rebate of 80 per cent available to those on supplementary benefit or lower levels of income. The reduced rate band would provide some help to those on low incomes, but above SB levels. It would be possible also to have a higher rate band, to reduce the standard charge by exacting a larger contribution from high income groups. Government would specify both the income bands and the ratios between the charges. A basic scheme could look as follows:

Lowest band (benefit levels of income)	20% of standard charge
Reduced band:	50% of standard charge
Standard band:	100% of standard charge
Higher band:	125% of standard charge

5.4 Such a scheme produces the following results for a household facing the average residents' charge:

i. Average residents' charge (weekly payment for a two-adult household)

Lower band	=	£1.16
Reduced band	=	£2.90
Standard band	=	£5.80
Higher band	=	£7.25

Those results might be acceptable with relatively small weekly losses entailed by movement between bands. But combined with the other LGFS changes, we concluded it produces unacceptable poverty traps for those in high spending authorities:

ii. Camden's residents' charge

Lower band	=	£4.79
Reduced band	=	£11.97
Standard band	=	£23.94
Higher band	=	£29.92

5.5 Under both a graduated scheme and a rebate scheme along the lines of that incorporated in the Social Security Review the minimum payment by those on benefit levels of income will be the same. But whereas a rebate scheme tapers the loss of rebate as income rises, under a banded graduated scheme there would be deep poverty traps associated with each income band. This would not matter greatly if the spread around the average residents' charge was fairly narrow - but the present range is from £62.00 in Gillingham to £624.07 in Camden.

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5.6 There are additional administrative complexities involved in a graduated charge with a higher rate band. This would require the assessment of the income of every resident in the authority and would have to be backed by effective sanctions if the higher rate were not to become a voluntary tax. That would mean involving local authorities in the business of checking income declarations at considerable administrative cost. The alternative, of integrating collection with PAYE would reduce the accountability gain (the residents' charge would pale into insignificance against aggregate PAYE payments) and would offer no way of collecting the charge from non-income tax payers.

5.7 A further complication would arise on the grant side. To ensure that every authority levied the same standard charge for spending at assessed need, the grant system would have to compensate authorities with a concentration of people paying the low or reduced rates and reduce the grant payable to those with disproportionate numbers of people on the higher rate. This would complicate the grant system.

5.8 The property element in the local charge is administratively much simpler and, insofar as better-off households generally live in larger properties (or more valuable properties if capital values are used to determine rateable values) will also reduce the regressivity of the local tax system without the administrative complexities entailed by a higher rate residents' charge.

5.9 That means assistance for those on low incomes will have to be provided through a rebate scheme. This is discussed in the following section.

C. REBATING THE LOCAL CHARGE

5.10 This section describes and discusses the interaction between our proposals and those of the social security review. Our aim is to suggest a rebate scheme which would provide help to the poorest whilst making sure that they, like everyone else, are aware of the cost of the local services they receive.

5.11 Under the present system means-tested help with rates bills is provided through the Housing Benefit scheme. 6.1 million households in England* receive benefit, of which 3.2 million qualify automatically because they are on supplementary benefit. The other 3 million low-income households get some assistance with their rates on the basis of a means test administered by local authorities - the amount they receive depends on the composition of the household, the size of their rates bill and their weekly income. The total cost of rate rebates in 1985/86 will be around £1,400 million; people on supplementary benefit receive, on average, £4.50 a week (£230 a year) in rebates and other low income households, £3 a week (£150 a year).

5.12 The Green Paper "Reform of Social Security" (Cmnd 9518) proposed changes to the Housing Benefit scheme which would make it more equitable, simpler to administer and for the public to understand, and which would control the size of the scheme by directing resources to those most in need of help. One result of the proposals would be to reduce the total cost of rebates by around £500 million, partially by reducing the numbers of households not on supplementary benefit who can get help. People with low housing costs - such as owner occupiers paying only rates and not rent - would, in general, lose benefit. On the other hand working families on low wages, especially those with high rents, would gain.

*The present rebate scheme covers the whole of Great Britain and the benefit costs given in this annex are, therefore, on a national basis.

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5.13 The Green Paper also proposed that everyone, even the poorest, should pay a minimum contribution (perhaps 20%) towards their rates. Not only would this generate around half of the savings being sought from the review but it would also strengthen the accountability of local authorities to their electorate by removing arrangements which at present allow over 3 million households (those on supplementary benefit) to pay no rates at all.

a. Effect of moving to the local charge

(i) Numbers subject to means-testing

5.14 A central objective of our proposals is to broaden the tax base so that as many people as possible are aware of the cost of local services. 17 million people who do not get a rates bill at present will get a bill for the residents' charge, and a number of those will have low incomes and will, therefore, be eligible for a rebate. We estimate that our proposals will extend means testing to another 700,000 tax units in England. Some 500,000 of these will be people who do not get rates bills because they are living in another person's home - in the main, elderly people living with their children or young adults living with their parents. Householders will still be eligible for rebates on the property charge element.

(ii) Benefit costs

5.15 We estimate that the benefit cost will increase by about £35 million a year in England under our proposals. Local authorities' administrative costs will also increase because of the extra caseload.

(iii) Shape of a rebate scheme

5.16 The replacement of domestic rates by the local charge should not require amendment to the main features of a reformed Housing Benefit scheme, as set out in the Social Security Green Paper. In assessing how individual households will be affected by the change to the local charge, we have incorporated the proposals of the Social Security Review in our exemplifications. The most important of these proposals are:

i. the income test should be the same for everyone, whether they are receiving benefit or not (to avoid the unemployment trap which exists under the present scheme);

ii. the calculation of rebates should be based on net, rather than gross, income (to contain the high marginal tax rates payable by low income families);

iii. maximum rebates should be payable to anyone whose net income was equal to or less than supplementary benefit level;

iv. there should be a single rate of withdrawal of benefit for everyone whose income is above supplementary benefit level.

5.17 We rejected, during this study, two other ways of providing help to low income households. Exempting recipients of social security benefits from payment of the local charge would run directly counter to our objective of making all adults aware of the cost of local services. Passporting certain groups of beneficiaries onto a reduced rate of charge, with no rebates for those not in receipt of benefit, would result in substantial work disincentives in areas with a high local charge.

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(iv) The minimum payment

5.18 It is crucial to our proposals that as many local electors as possible should be aware of the cost of the local services they receive. The Social Security Green Paper put forward the view that everyone should pay a minimum contribution towards their rates and this will be vital to our objective. If the minimum contribution is set at 20%, a single person on supplementary benefit or a lower level of income, with an average residents' charge, and living in a property of average rateable value would face a bill of 76p a week (£40 a year); a couple living in a property of similar rateable value would face a bill of £1.17 a week. These compare with the average of just under £1.24 a week which these households would pay towards rates.

5.19 Compared to a system of domestic rates, combined with our other proposals, most single people will gain, whereas low income couples, with average or below average rate bills may lose. The largest losers will be in high spending areas, where the impact of our other changes will be greatest: those for example on benefit in an Inner London authority meeting 20% of their current rates bill would pay £1.89 on a property of two thirds average rateable value a but, under our package they would jointly need to find £3.52 a week if they must meet 20% of the total local charge. The difference between these amounts is equal to 3.6% of the current supplementary benefit scale rate.

5.20 The effect on the net incomes of those on supplementary benefit of requiring everyone to pay at least 20% of their local tax bill will depend on the benefit rates. An increase in supplementary benefit ("churning") would, under the Social Security Green Paper proposals, lead automatically to an increase in housing benefit and family credit. These issues are, however, outside the scope of the Local Government Finance Studies.

Administration

5.21 A combined tax could complicate the administration of a rebate scheme along the lines of the Social Security review proposals compared to a simple flat-rate residents' charge only. The widening of the tax base to non-householders will increase the caseload. At present non-dependents living in the household are expected to contribute towards rates and there are offsets in the rate rebate scheme for property which is only partially residential and for sub-tenancies. We would need to decide whether to continue these provisions for the much reduced property charge. Scrapping these provisions would simplify the administration of rebates and thus help to mitigate the burden of the extra caseload on authorities, but would entail some increase in benefit costs.

5.22 We have considered ways of avoiding the potential extra administrative complexity. One possibility would be to exempt those entitled to a rebate of the "people" element from payment of any "property" element - but this would create severe poverty trap effects, especially in areas with high local tax rates.

5.23 Under a local charge, the minimum contribution could be applied to the residents' charge, the property charge or both. Applying it only to the property element would allow non-householders paying only the residents' charge to receive a 100% rebate with a consequent loss of perceptibility of the cost of local services among this group. Applying the 20 per cent minimum to both elements could mean that the contribution payable by non-householders might be very small - only an average of 41 pence a week if the minimum contribution is 20% (In comparison, a single householder would pay an average of 76 pence a week). One option would be to allow 100 per cent rebates of the

property charge, but apply a lower maximum rebate than that proposed in the Social Security review to the residents' charge, say of 70 per cent, so that everybody would pay a minimum 30 per cent of the residents' charge. A single taper could apply to the whole local charge payment.

D. CONCLUSIONS

5.24 Despite the increased benefit costs and caseload, compared with the rebate scheme developed in the Social Security review applied to rates, we believe that a rebate system is a more attractive way of helping low income groups with the local charge than a graduated scheme which would require local authority means-testing of all households, while not avoiding deep poverty traps for low income families in high spending areas.

ANNEX 6

CAPITAL

A. INTRODUCTION

6.1 This annex reports progress on the separate review of local authority capital expenditure controls, which must mesh in with our decisions on the local government finance system as a whole.

B. CURRENT POSITION

6.2 The issues affecting control of capital expenditure were discussed at Annex E to the specification report of May 1985. The five options under consideration are:

i. new borrowing for capital purposes (annual block borrowing consents for each authority, which would be considered exercised, as under the present system, whether the authority borrowed externally or used temporarily surplus cash from within the authority);

ii. net external borrowing for capital purposes (borrowing limits would be set for each authority, against which all external borrowing for capital purposes would count, including the withdrawal of money from deposit);

iii. all net external borrowing (covering borrowing temporarily for revenue purposes as well as borrowing for capital) controlled by means of external financing limits (EFLs);

iv. net capital expenditure (a refinement of the present system which aims to control capital expenditure net of capital receipts during the year);

v. gross capital expenditure (which would ignore variations in in-year capital receipts, but maintain by other means an incentive to sell surplus assets).

6.3 We have discussed the five options with the local authority associations and invited their comments. All the associations have subsequently confirmed their preference for option (i) above. This option would leave authorities complete freedom to apply in-year and accumulated receipts to capital expenditure, further supplemented by other available sources of finance: grants, capital funds or direct contributions from revenue. To the extent that additions to revenue expenditure fell directly on electors, this option would be good for accountability. But in its present form it offers far too little control over annual capital expenditure or over the annual local authority borrowing requirement (LABR). Moreover, the Government would have very little influence over spending priorities. We are considering whether this option can be improved to provide adequate control.

6.4 The two expenditure options (iv and v) are developments of the present system. The local authority associations are much less keen on these options than on option (i) on the grounds that they offer insufficient flexibility and stability to enable authorities to plan cost-effective programmes. In operation, the system of control on net expenditure has also failed to deliver our objectives of controlling expenditure in line with PESC provision. Either approach is essentially centralist and bad for accountability. But we cannot rule out these options until we are certain that something workable can be devised.

6.5 Accordingly, we are concentrating at this stage on exploring the feasibility of the two radical options for the control of net external borrowing, which have considerable attractions. At national level, we ought to be concerned primarily with the local authority borrowing requirement, not so much with the precise level of local authorities' capital expenditure where it is financed from revenue or in-year capital receipts.

6.6 Control of net external borrowing for capital would reflect this priority. But it has been criticised by the associations on the grounds that it would necessitate uneconomical changes in authorities' mode of financial operation. We are considering whether a variant could be produced to overcome that problem.

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6.7 A net external borrowing option based on EFLs would reflect the same priority, leaving authorities scope to decide for themselves where to put the emphasis at the margin between revenue and capital expenditure. Clearly we could not hope to set tailor-made EFLs as we do for the nationalised industries for each of nearly 500 authorities. We should rather have to base the EFL on our assessment of the need for capital spending, perhaps with an allowance for past capital receipts and assume that revenue borrowing was neutral. To make the aggregate of EFLs equivalent to our target LABR we should have to reduce each on a formulaic basis, related say to population.

6.8 Such EFLs would not accurately reflect the circumstances of individual authorities, and we should therefore need a safety valve. One possibility would be to establish a closed local authority borrowing market through which authorities with surplus borrowing consent could in effect either lend or sell their rights to authorities in danger of exceeding their EFL. So long as the market was restricted to local authorities, its operation would not add to the LABR. In the first instance the Bank of England might need to regulate its operation, but after a while it should run itself.

6.9 The associations are, for the most part, very hesitant about this option, partly because it would be a new departure and they are uncertain how it would work. Although we are attracted by the approach, it would represent a radical change in our approach to local authority finance, and would require major changes also in the financial operations of authorities. There are a number of major practical snags to be resolved. We are urgently exploring the practical implications, in consultation with the local authority associations and the Bank, and will report back later in the autumn. In the meantime, we are regarding all five options as still open in our discussions with local government and other outside interests.

ANNEX 7

DETAILED RESULTS

A INTRODUCTION

7.1. This annex contains supplementary information, to that contained in Section V of the Report, on the detailed distributional impact of proposals. These further results cover:

- the effects on areas
- the effects on households
- the effects on tax units

B THE EFFECTS ON AREAS

7.2. Table 1 shows the effects of our revised package on average domestic tax bills in each region. Average tax bills in the South East fall by a third, reflecting the gains to low spending areas from the national non domestic rate combined with the effects of abandoning domestic resource equalisation for high rateable value areas. Conversely, average tax bills in the Northern Region increase by a corresponding amount because of high spending combined with low rateable resources. Average tax bills in London - already the highest in the country - increase overall, despite the gains from ending resource equalisation, because of high spending, mostly in Inner London. The gains to local taxpayers in the East and West Midlands mainly reflect the effects of low spending.

7.3. Table 2 compares the distribution of average domestic tax bills expressed as a cost per adult, between areas now and under our proposals. The range is summarised below:

	Cost per Adult	
	Lowest	Highest
Now	£83	£510
May Package	£57	£785
Revised Package	£62	£624

The modifications which we have made to the package since May have mainly reduced the extremes at the top end. The range of variation remains wide but has to be seen against the existing wide variations in domestic tax bills between areas.

C THE EFFECTS ON HOUSEHOLDS

7.4. Tables 3a) and 3b) compare the pattern of gains and losses by household type resulting from our proposals -

- with full retention of domestic rates and,
- with the proposed local charge

They show how the switch from domestic rates to the local charge benefits single adult households at the expense of large (3 or more adult) households. With the local charge, there are very few losses more than 5% of net household income, although there are a significant number of large gains. 6% of single pensioner households and 3% of other single adult households would have reductions in local tax bills equivalent to 5% or more of net income.

7.5. Table 4 compares, for these different types of household, the average proportion of net income paid in local taxes under the present and proposed systems at different income levels. It can be seen that single pensioner and non pensioner households are better off at all income levels, while large households with 3 or more adults pay a higher proportion of income in local taxes throughout the range. Low income couples are marginally worse off while higher income couples gain. However for all types of household, the proportion of income paid in local taxes declines as income rises more rapidly under the new regime than under the present regime.

7.6. We have also looked at the geographical distribution of large gainers and losers - those households with reductions/increases in net local tax bills of more than £2 per week. The table below summarises the results by region:

Distribution, by Region, of Households Gaining and Losing more than £2 per week [under Revised Proposals with Local Charge]

	No. Gaining more than £2 per week million	No. Losing more than £2 per week million
Northern	0.02	0.36
Yorkshire and Humberside	0.06	0.37
East Midlands	0.19	0.09
East Anglia	0.14	0.02
Greater London	0.40	0.75
South East	1.56	0.04
South West	0.29	0.05
West Midlands	0.58	0.04
North West	0.32	0.32
TOTALS	3.56	2.04

7.7. This shows the extent to which large gainers and losers are concentrated in particular regions. 60% of households gaining more than £2 per week live in the South East (excluding London) and West Midlands; 70% of households losing more than £2 per week from higher local tax bills live in the Northern Region, Yorkshire and Humberside and Greater London. London is unique in having concentrations of large gainers and losers.

7.8. The gains and losses described above are the combined result of our proposals on grant and non domestic rates together with the switch from domestic rates to the proposed local charge. Table 11 of the Specification report isolates the effects of the move from domestic rates to the proposed local charge on the proportion of net income paid in local taxes for households in different income bands. It shows how net tax payments for low income households would be reduced under the local charge. The major reason for this is that in the lowest income bands, the majority of households have only one adult.

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7.9. However, these results take no account of the fact that to provide the same standard of living, large households need more income than smaller households. This can be allowed for by adjusting household income for the effects of size and composition. Table 5 shows the effects of doing this using equivalence scales based on relative levels of income support provided by supplementary benefit rates. On this "equivalent income" basis, the results show a rather different pattern. Although low income households are marginally better off from the local charge, there is a much more marked pattern of gains among higher income households more of whom, on an equivalent income basis, tend to be single and two adult households. Thus, if we adjust income for family size, it is clear that over a broad range of income the local charge is more regressive than domestic rates. Relatively better off households pay a smaller proportion of net income in local taxes under the proposed local charge - between 1 - 2% of net income, on average,compared with between 2 - 3% under rates. This is a necessary corollary of introducing a large flat rate element of local taxation.

7.10. This effect is also evident in comparing the distribution of tax payments by income for particular household types. Tables 6a)- 6c) show for some illustrative household types how the proportion of income paid in local taxes varies under the new finance regime with domestic rates retained and with the proposed local charge. The households types covered are as follows:

- single pensioner (Table 6a)
- couples with 2 children (Table 6b)
- 3 adult households (Table 6c)

7.11. The tables show two things: first, that tax payments as a proportion of income tend to decline more rapidly under the proposed local charge than with rates. Second, they show the extent of shifts in tax incidence between different household types. Thus table 6a) shows that single adult pensioner households are better off at all income levels under the local charge, while large households with 3 or more adults, on average, pay more throughout the income range. This illustrates the dominant effect of household composition on changes in tax incidence.

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D THE EFFECTS ON TAX UNITS

7.12. Tax units, in this analysis, comprise individuals or groups of individuals, such as husband and wife, who would be jointly assessed for purposes of Social Security benefit. There are 17.8m households in England and 22.8m tax units. Three quarters of tax units are also households. The rest comprise non dependent adults who are non householders, such as young people living at home.

7.13. Table 7 shows the regional pattern of gains and losses in weekly tax bills among tax units arising from the implementation of the new system with the new local charge. It shows that a somewhat smaller proportion of tax units than households gain under the new system - 55% of tax units compared with 58% of households. This is a consequence of widening the tax base and bringing more tax units into the local taxation system. Otherwise, the general pattern of gains and losses across regions follows that for households.

7.14. Tables 8a) - 8b) compare the distribution of gains for different tax units arising under the new system.

- with full retention of domestic rates and,
- with the proposed local charge (with the property element based on existing rateable values)

The tables show how - in moving from domestic rates to the proposed local charge - the number of tax units who gain from our proposals is reduced from 66% to 55%, with one parent families and single adults (other than pensioners) incurring the biggest losses. This is because many single adults live in multiple tax unit households and directly pay local taxes for the first time. However, one parent families, single pensioners and couples with 2 or more children all fare better than average under the new regime, while other single adults (mostly non dependent, non householders) and pensioner couples fare worse than average.

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E SENSITIVITY ANALYSIS

7.15. One of the main ways in which we have modified our proposals since May is by incorporating assumed expenditure reductions arising from precept control of ILEA and of transport joint boards in the metropolitan areas. These have the effect of reducing the required yield from the local charge under the new system by just under 6% compared with the revenue raised by domestic rates in our 1984/85 base position. It is one reason why there are more households gaining than losing under our proposals.

7.16. In practice, these expenditure reductions will accrue over a number of years and would not be available in one year to offset increases in tax bills arising from the full implementation of the new system. Consequently, as indicated in Section V of the main report, comparing tax bills under the new system incorporating expenditure reductions, with present rate bills, will tend to overstate the gains and understate the losses likely to be perceived in the changeover to the new system.

7.17. To measure the sensitivity of our results to these expenditure assumptions, we have produced a separate set of exemplifications assuming that 1984/85 expenditure levels are maintained under the new system. Table 9 shows the distribution of changes in weekly local tax bills for households, by region, arising from our proposals with the new local charge, but without expenditure reductions.

7.18. Compared with Table 8 in section V of the main report, which incorporates the spending reductions, Table 9 shows that a smaller proportion of households gain from our proposals -57% instead of 59%. The effects, as expected are most marked in Yorkshire and Humberside and Greater London. Non metropolitan areas are unaffected. In Greater London, the proportion of households losing rises from 60% to 64% and 18% of households lose more than £5 per week. These results suggest that the effects of the expenditure reductions are very localised and that the overall pattern of gains and losses nationally is not significantly affected by the expenditure assumptions we have used.

F CONCLUSIONS

7.19. The main conclusions from our analysis are as follows:
(1) The main determinant of whether households gain or lose is where they live. Households in high spending/low rateable value areas generally face tax bill increases; those in low spending/high rateable value areas generally face reductions. Because, outside London, low rateable value appears to be correlated with high spending, this produces a strong regional pattern of gains and losses.

(2) Whether households gain or lose from the switch from rates to the local charge depends upon household composition and rateable value. The biggest gains from the change in the tax base are to single adult households with high rateable value property while the biggest losses are to large households with 3 or more adults in low rateable value property. For most of these households the gains and losses arising from the change in the local tax base are greater than the effects of changes to the grant system and non domestic rates.

(3) On average the package benefits low income households the majority of whom have only one adult. However, if we adjust income for family size, we find that the biggest relative gains accrue to higher income households. The introduction of a large flat rate element of local taxation means that for any household type, the proportion of income paid in local taxes declines more rapidly with increasing income under the local charge than with rates.

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Effect Of Revised LGFS Proposals On Areas

	Overspend per adult against current GRE Col 1	=== Cost Per Adult === Now Col 2	Chequers package Col 3	--- Effect On Cost Per Adult Of --- Revised spending assumption Col 4	Revised GREs Col 5	5% local non-domestic rates Col 6	Revised LGFS Package Per adult local tax bill Col 7	Total change from now Col 8
gland	£ 42.89	£ 160.32	£ 160.13	£-9.22	£-.01	£-.00	£ 150.90	£-5.88%
n	£ 61.57	£ 131.97	£ 178.82	£-5.64	£ 1.49	£ 2.55	£ 177.22	£ 34.29%
e and Humberside	£ 41.81	£ 119.29	£ 159.05	£-16.25	£ 2.08	£ 2.61	£ 147.49	£ 23.64%
ast	£ 38.66	£ 146.33	£ 155.90	£-7.20	£-1.67	£ 2.20	£ 149.23	£ 1.98%
lands	£-6.79	£ 127.23	£ 110.46	-	£ 4.08	£ 2.00	£ 116.53	£-8.41%
lands	£-10.96	£ 147.65	£ 106.28	£-3.65	£ .04	£ 1.30	£ 103.97	£-29.58%
lia	£-22.08	£ 135.01	£.95.16	-	£ 7.10	£ 1.86	£ 104.12	£-22.89%
London	£ 243.97	£ 259.61	£ 361.21	£-38.86	£-18.27	£-10.95	£ 293.13	£ 12.91%
ast	£-14.27	£ 165.61	£ 102.97	-	£ 6.09	£ 1.11	£ 110.17	£-33.48%
ast	£-13.76	£ 131.38	£ 103.48	-	£ 6.95	£ 2.79	£ 113.23	£-13.82%

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TABLE 2

Cost Per Adult : Current System And Proposed System

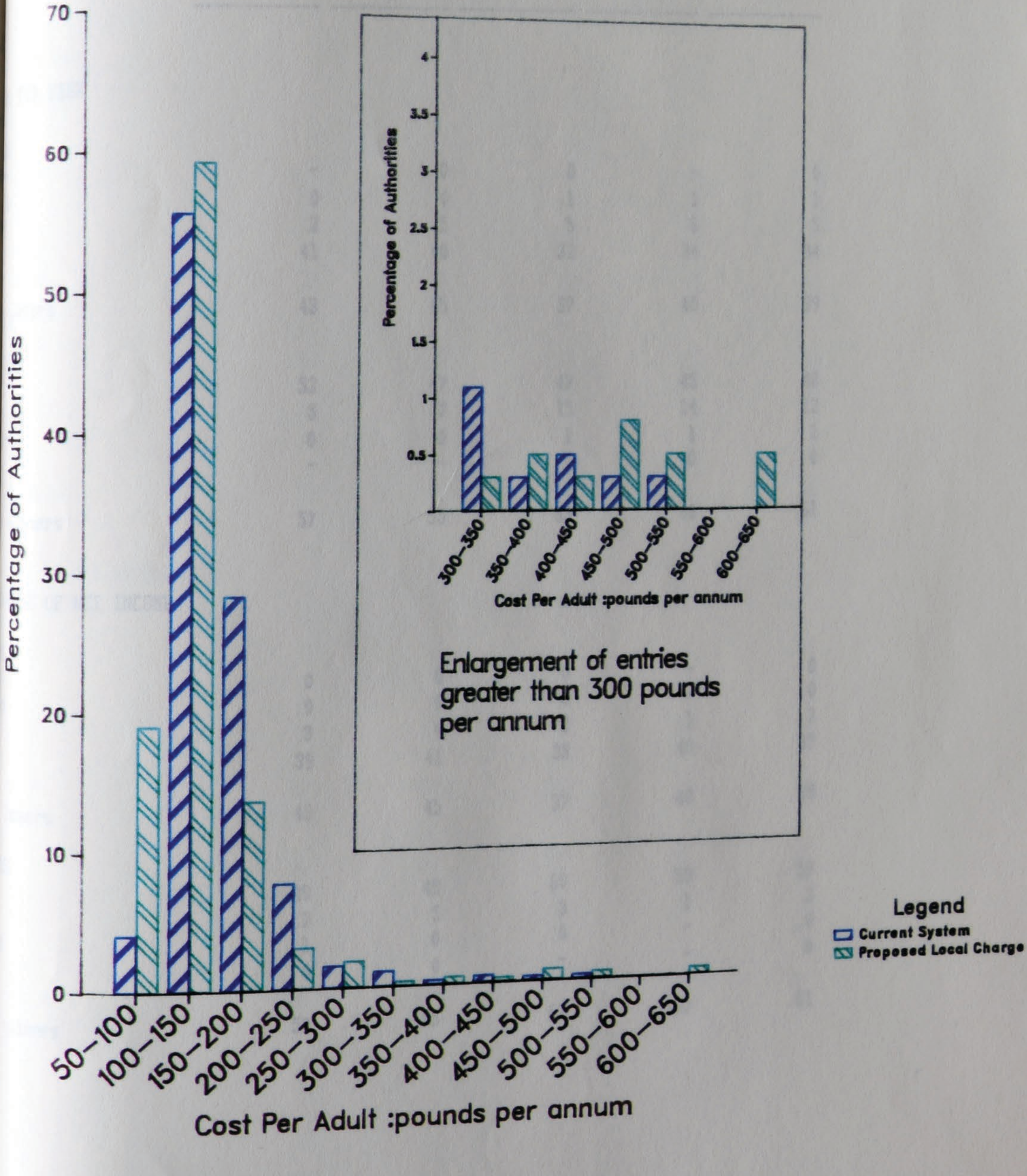

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Table 3a

LGFS Revised Package (Retain Rates)
Percentage Of Gainers And Losers : Household Type

	Single pensioner %	Other single adult %	Two adults %	Three or more adults %	All households %
S PER WEEK					
S					
	-	0	0	-	0
	0	0	1	1	1
	2	5	5	6	5
	41	40	32	34	34
losers	43	45	37	40	39
ERS					
	52	47	47	45	48
	5	7	15	14	12
	0	0	1	1	1
	-	-	0	0	0
gainers	57	55	63	60	61
NTAGE OF NET INCOME					
S					
	0	0	0	-	0
	0	0	0	-	0
	3	4	2	1	2
	39	41	35	40	37
losers	43	45	37	40	39
ERS					
	49	49	60	59	57
	7	5	3	1	3
	1	0	0	-	0
	0	0	-	-	0
gainers	57	55	63	60	61

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Table 3b

LGFS Revised Package (Local Charge)
Percentage Of Gainers And Losers : Household Type

	Single pensioner %	Other single adult %	Two adults %	Three or more adults %	All households %
S PER WEEK					
	-	-	0	2	0
	0	0	1	8	2
	0	3	8	27	9
	21	21	33	32	30
l losers	21	25	43	70	41
	61	49	36	21	39
	14	22	18	7	16
	3	4	3	1	3
	0	0	0	0	0
l gainers	79	76	57	30	59
NTAGE OF NET INCOME					
	-	0	0	-	0
	0	1	0	1	0
	1	3	5	9	5
	20	20	38	60	36
losers	21	24	43	70	41
	56	54	51	29	49
	17	19	6	1	8
	5	3	0	0	1
	1	0	0	-	0
gainers	79	76	57	30	59

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Table 4

LGFS Revised Package (Local Charge)
Local Tax As A Percentage Of Net Income

	Net income range < £50	50 - 75	75 - 100	100-150	150-200	200-250	250-300	300-350	350-400	400-500	500 +
TION TAX PAYMENTS											
nsioner	3.7	5.2	6.6	5.5	4.7	4.0	2.9	3.3	3.1	2.1	3.0
gle adult	4.1	3.8	4.3	4.2	3.6	3.3	3.3	2.4	2.3	2.1	1.8
	5.0	3.0	3.7	3.8	3.3	2.9	2.7	2.6	2.5	2.4	2.1
s	4.0	3.4	2.6	2.9	2.7	2.4	2.2	2.0	1.9	1.9	1.6
HOLDS	3.9	4.0	4.1	3.9	3.2	2.8	2.5	2.4	2.2	2.1	1.9
H											
nsioner	2.9	3.8	4.2	3.2	2.3	2.1	1.2	1.5	1.1	.9	2.0
gle adult	3.5	3.0	3.3	3.1	2.3	1.9	1.9	1.4	1.0	1.5	.6
	5.2	3.2	3.8	3.8	3.1	2.5	2.2	1.9	1.7	1.5	1.1
s	5.9	5.3	2.9	3.3	3.5	3.0	2.9	2.5	2.4	2.3	1.7
HOLDS	3.2	3.4	3.7	3.7	3.1	2.6	2.4	2.2	2.1	1.9	1.4

Household types:

- single pensioner
- other single adult
- 2 adults
- 3 or more adults

Table 5

Net Local Tax As A Proportion Of Equivalent Income (average for income band)

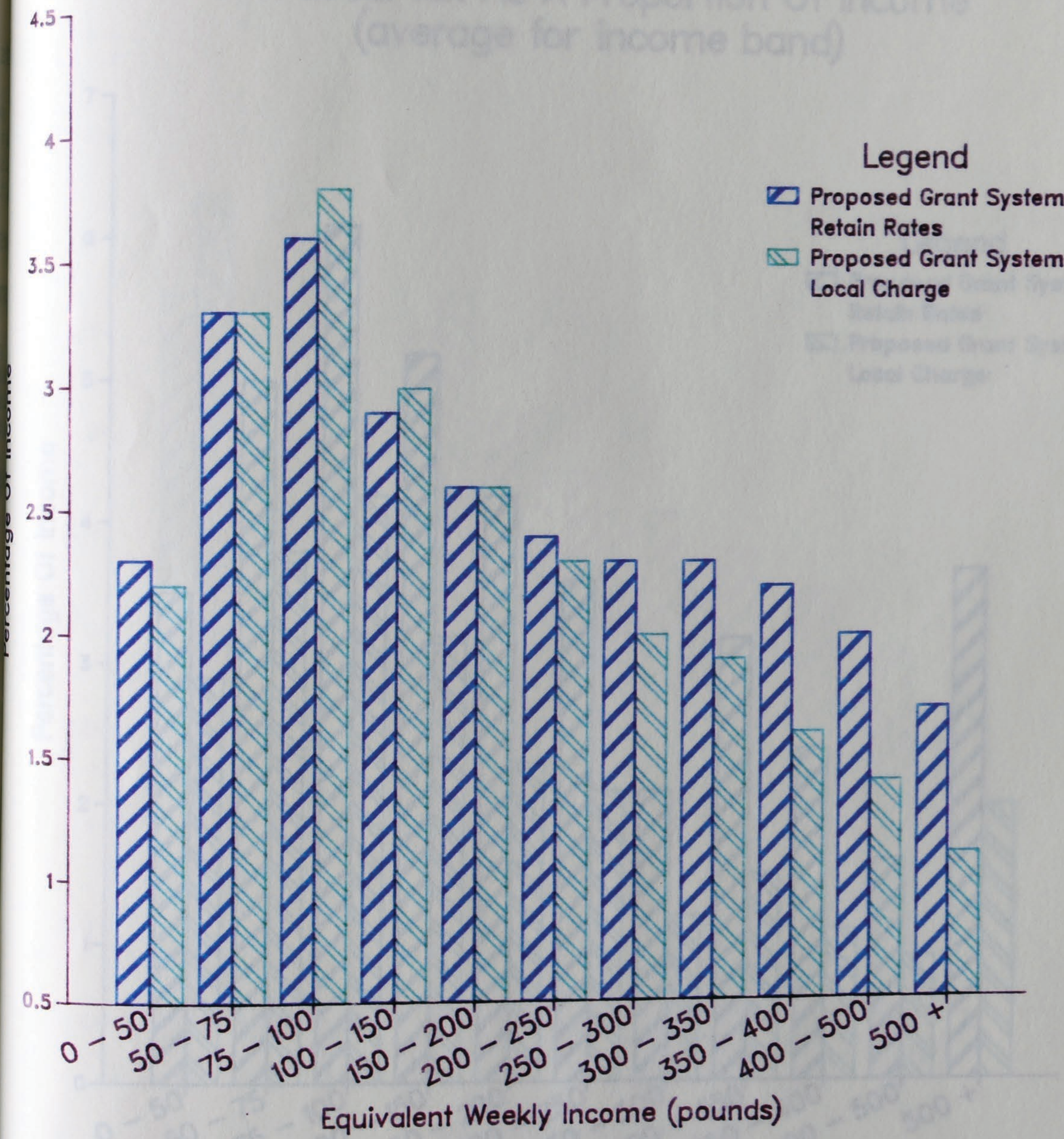

Table 6 a)

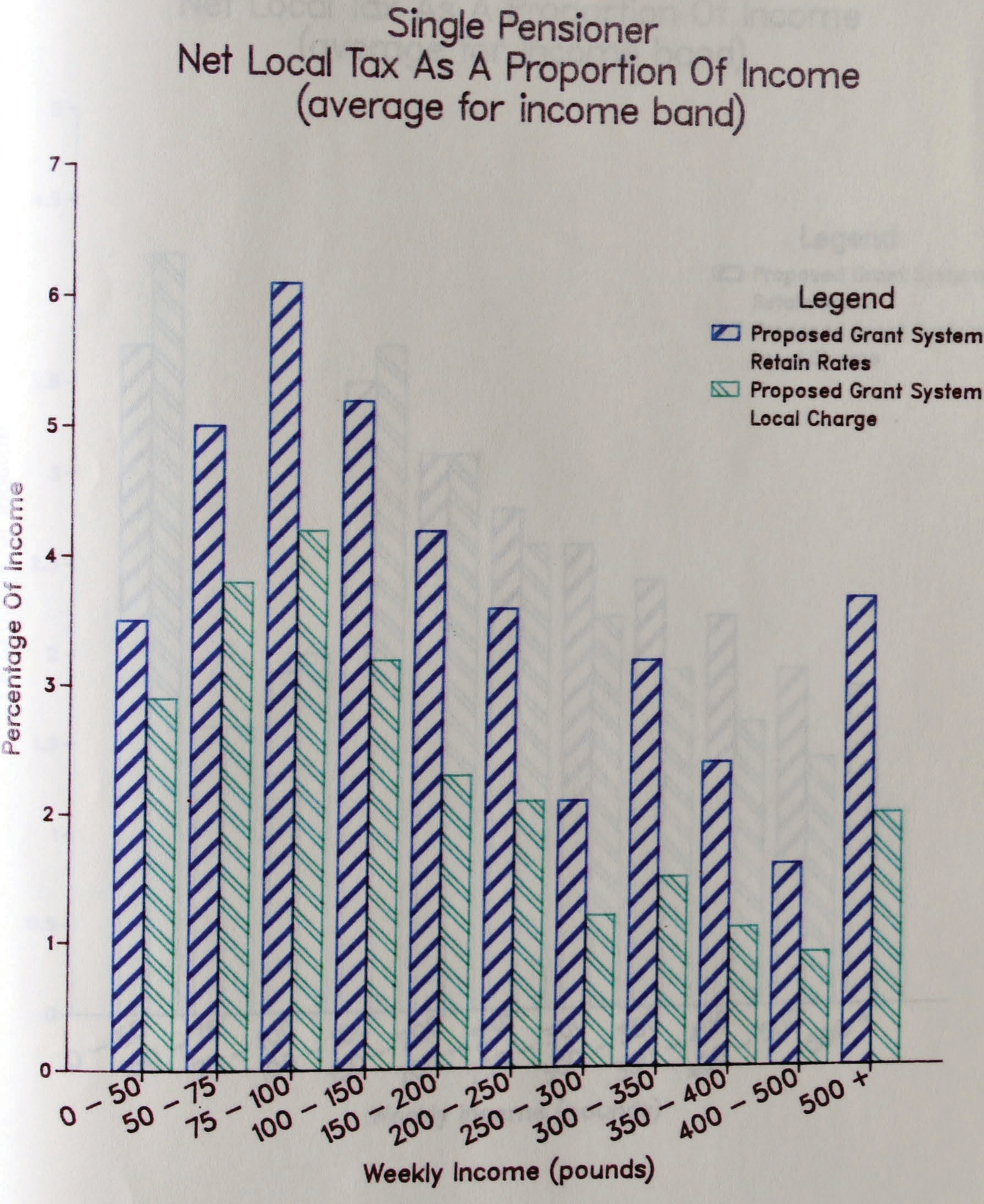
Single Pensioner
Net Local Tax As A Proportion Of Income
(average for income band)
Percentage Of Income
0
1
2
3
4
5
6
7
Legend
Proposed Grant System Retain Rates
Proposed Grant System Local Charge
0 - 50
50 - 75
75 - 100
100 - 150
150 - 200
200 - 250
250 - 300
300 - 350
350 - 400
400 - 500
500 +
Weekly Income (pounds)

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Table 6b)

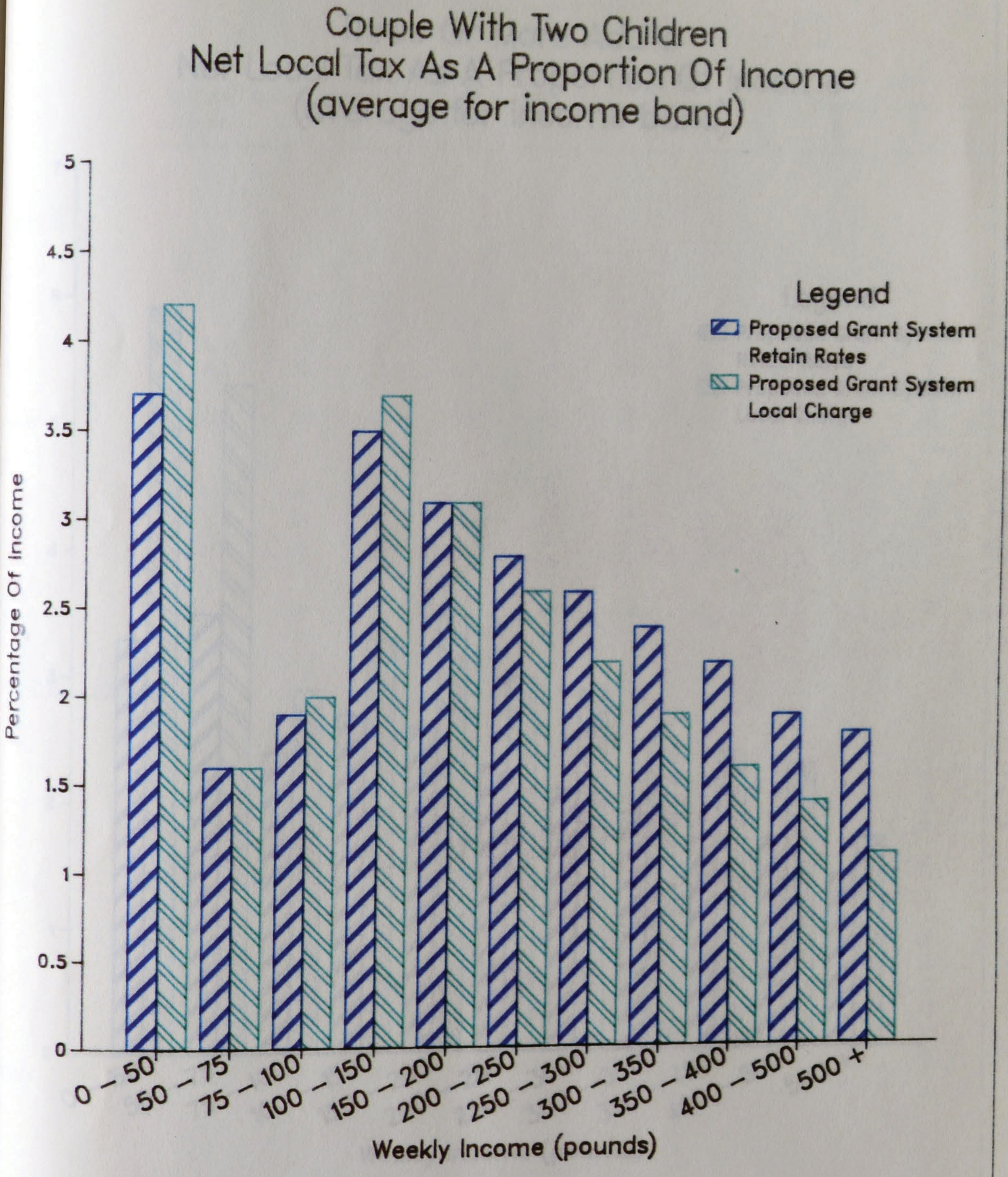

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Table 6c)

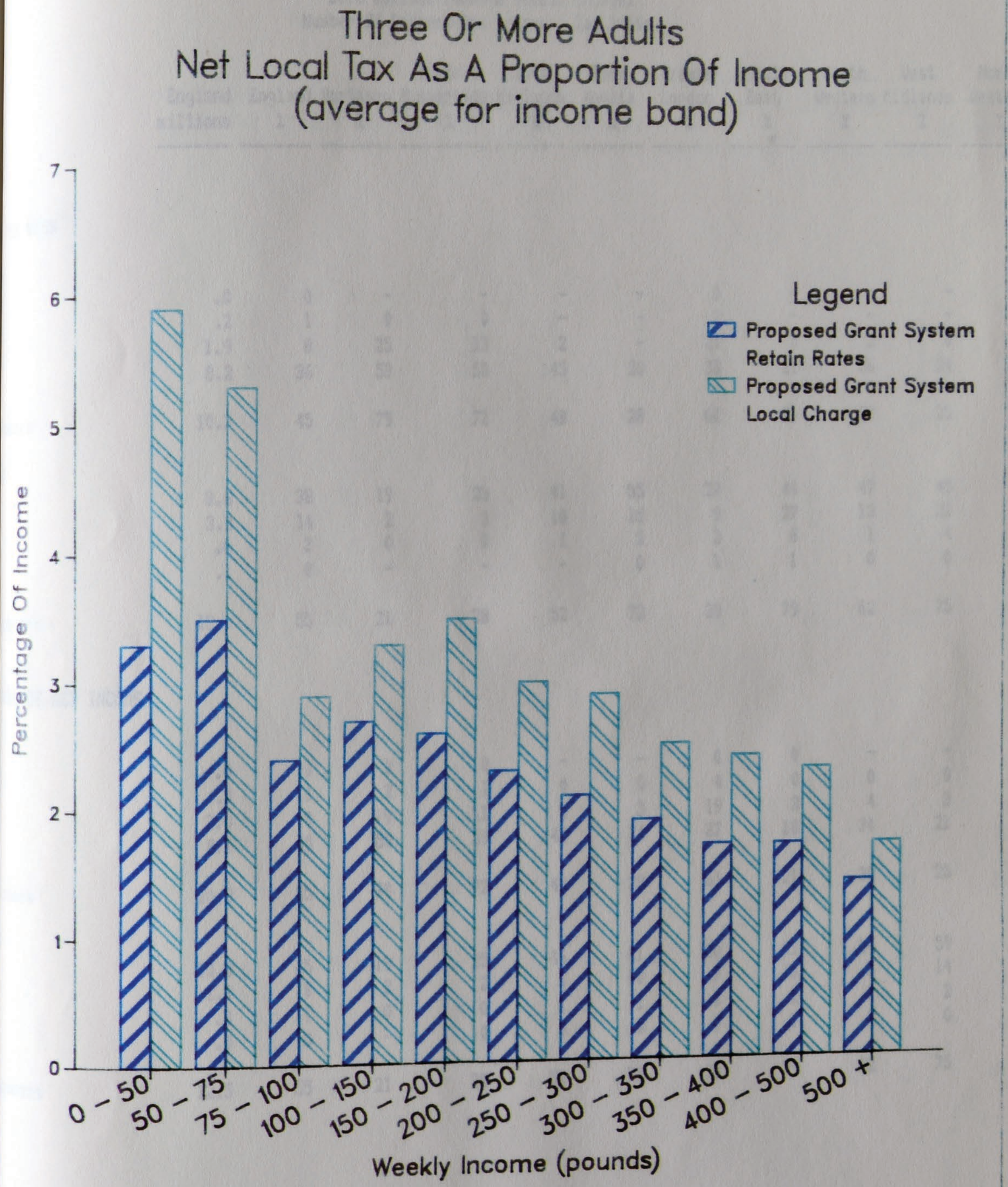

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Table 7

LGFS Revised Package (Local Charge)
Number Of Gainers And Losers : Tax Units

PER WEEK

	England millions	England %	Northern %	Yorks & Humberside %	East Midlands %	East Anglia %	Greater London %	South East %	South Western %	West Midlands %	North Western %
	.0	0	-	-	-	-	0	-	-	-	-
	.2	1	0	0	-	-	7	-	-	-	0
	1.9	8	25	13	2	-	21	1	2	0	12
	8.2	36	53	58	45	28	33	21	36	24	40
losers	10.3	45	79	72	48	28	61	21	38	25	52
	8.6	38	19	25	41	55	27	44	47	49	37
	3.2	14	2	3	10	15	9	27	13	22	10
	.6	3	0	0	1	2	2	6	1	4	1
	.1	0	-	-	-	0	1	1	0	0	0
gainers	12.5	55	21	28	52	72	39	79	62	75	48

TAGE OF NET INCOME

	England millions	England %	Northern %	Yorks & Humberside %	East Midlands %	East Anglia %	Greater London %	South East %	South Western %	West Midlands %	North Western %
	.0	0	0	0	-	-	0	0	-	-	0
	.3	1	2	1	0	0	4	0	0	0	1
	2.0	9	19	11	5	3	19	3	4	3	10
	8.1	35	58	59	42	24	37	18	34	21	40
losers	10.3	45	79	72	48	28	61	21	38	25	52
	10.2	45	19	25	46	61	30	61	54	59	41
	1.9	8	2	2	5	10	7	15	7	14	6
	.3	1	0	0	1	1	2	2	1	2	1
	.0	0	-	0	0	0	0	0	0	0	0
gainers	12.5	55	21	28	52	72	39	79	62	75	48

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Table 8a

LGFS Revised Package (Retain Rates)
Number Of Gainers And Losers : Tax Unit types

	Single pensioner	One parent family	Other single adult	Pensioner Couple	Non Pensioner Couple: without children	Non Pensioner Couple: 1 child	Non Pensioner Couple: 2 children	Non Pensioner Couple: 3+ children	ALL HOUSEHOLDS
S PER WEEK									
	-	-	0	-	-	-	0	0	0
	0	0	0	0	0	0	1	1	0
	2	1	2	3	5	6	6	5	4
	38	19	26	35	32	31	28	31	30
losers	40	20	29	39	37	37	35	38	34
	56	78	68	50	47	47	46	47	56
	4	2	3	10	15	15	19	14	9
	0	0	0	0	1	1	1	1	0
	-	-	-	-	0	-	0	-	0
gainers	60	80	71	61	63	63	65	62	66
TAGE OF NET INCOME									
	0	-	0	-	0	-	-	-	0
	0	0	0	0	0	-	0	0	0
	3	1	2	3	2	1	2	1	2
	37	19	26	36	35	35	33	36	32
losers	40	20	28	39	37	37	35	38	34
	54	79	68	54	60	61	63	61	62
	6	1	3	7	3	2	2	1	3
	1	0	0	0	0	0	0	-	0
	0	0	0	-	0	-	-	-	0
gainers	60	80	72	61	63	63	65	62	66

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Table 8 b)

LGFS Revised Package (Local Charge)
Number Of Gainers And Losers : Tax Unit types

	Single pensioner	One parent family	Other single adult	Pensioner Couple	Non Pensioner Couple: without children	Non Pensioner Couple: 1 child	Non Pensioner Couple: 2 children	Non Pensioner Couple: 3+ children	ALL HOUSEHOLDS
S PER WEEK									
RS									
+	-	-	-	0	0	-	-	-	0
10	0	0	1	1	2	1	1	1	1
5	2	7	11	8	11	10	7	7	8
2	31	34	46	43	32	32	27	32	36
l losers	33	42	58	52	45	43	35	41	45
ERS									
2	54	51	31	33	34	35	37	36	38
5	11	6	10	13	18	18	23	17	14
10	2	1	1	2	3	4	5	5	3
+	0	0	0	0	0	0	0	1	0
l gainers	67	58	42	48	55	57	65	59	55
NTAGE OF NET INCOME									
RS									
+	0	-	0	0	0	-	-	-	0
10	1	0	3	1	1	0	0	0	1
5	4	6	19	9	6	4	3	3	9
2	28	35	35	42	38	38	32	38	35
l losers	33	42	58	52	45	43	35	41	45
ERS									
2	49	52	31	38	48	52	58	54	45
5	14	6	9	9	7	5	7	5	8
10	4	0	2	0	1	0	0	0	1
+	1	0	0	0	0	0	-	-	0
l gainers	67	58	42	48	55	57	65	59	55

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Table 9

LGFS Revised Package : Sensitivity Test(Local Charge)
Number Of Gainers And Losers : Households

	England millions	England %	Northern %	Yorks & Humberside %	East Midlands %	East Anglia %	Greater London %	South East %	South Western %	West Midlands %	North Western %
ER WEEK											
	.2	1	0	0	-	-	7	-	-	-	0
	.5	3	4	6	0	0	11	0	0	0	1
	1.7	10	29	21	6	2	16	1	3	2	14
	5.3	30	50	52	39	20	30	12	30	17	38
osers	7.7	43	83	79	45	22	64	13	34	18	53
	6.7	38	15	19	42	58	24	46	49	53	36
	2.8	16	1	3	12	17	10	32	15	24	10
	.5	3	0	0	1	2	2	8	2	4	1
	.1	0	-	-	-	0	0	1	0	0	0
ainers	10.1	57	17	21	55	78	36	87	66	82	47
AGE OF NET INCOME											
	.0	0	-	-	-	0	1	-	-	-	0
	.2	1	1	1	-	-	9	-	-	-	0
	1.1	6	15	14	1	0	17	0	1	0	5
	6.4	36	67	63	43	22	38	13	33	18	48
osers	7.7	43	83	79	45	22	64	13	34	18	53
	8.4	47	15	20	50	68	29	69	58	67	42
	1.4	8	1	1	5	9	6	15	7	13	5
	.2	1	0	0	1	1	1	2	1	2	1
	.0	0	-	-	0	0	0	0	-	0	0
ainers	10.1	57	17	21	55	78	36	87	66	82	47

REJECTED OPTIONS

8.1. In Section III of the Main Report we referred to various options for reducing the size of the residents' charge. These are discussed in this Annex.

8.2. In that section we said that the easiest way of engineering a cut in the residents' charge was simply to increase the standard grant payable to each local authority. Insofar as authorities spending was unchanged this would translate into a uniform cut in the residents' charge.

a. Assigning a share of national taxation

8.3. Assigning a share of national taxation without an offsetting reduction in the standard grant would have exactly the same effect as increasing the level of standard grant. Any advantage would be purely presentational. We have looked at two possible candidates: a share of VAT and the whole of Vehicle Excise Duty (VED).

8.4. Assigning the proceeds of VED would reduce the residents' charge by £45 per adult across the country. Assigning 1% of VAT would reduce the residents' charge by £27 per adult across the country. In both cases the pattern would be the same - residents in low spending areas where the residents' charge is already markedly lower than the domestic rates bill would gain proportionately more, at the expense of the national taxpayer. The scale of local tax increases in low rateable value areas like Accrington would be reduced. But it does nothing to reduce the range of variation in the level of residents' charge between areas.

b. Transferring the whole of the cost of education to the exchequer

8.5. Education accounts for roughly half of local authority expenditure. Centrally funding all education spending would allow a substantial cut in the residents' charge. The advantages which could be adduced compared to achieving a similar cut through an increase in standard grant would be:

- the Government would arguably (but see below) be better able to secure uniformity of education standards across the country and implementation of special policy initiatives;

- education - about a half of local authority spending would be subject to a binding cash limit.

8.6. The drawbacks would be:

- Unless management of the education service were also centralised (and E(LF) were not attracted to that possibility) Education Ministers would have no power to control the way their funds were spent.

- There would be no local financial stake in education, and therefore unconstrained local pressure for improvement of the education service and no local pressure for economy. The government would be drawn into perpetual conflict with local authorities over the adequacy of the allocation for education to the area.

- It would call into question the two tier structure of local government in the shires: and shire counties' responsibilities would be drastically curtailed.

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- There would be no significant impact on local authority overspending. Of all the main services, spending on education is closest to the Government's PESC plans.

- Authorities might use the headroom created by the cut in the residents' charge to spend up on other services. There would be no additional leverage on those services.

c. Additional specific grants

8.7. An alternative approach would be to increase the volume of specific grants provided to support local authority services and thus reduce the required yield of residents' charge. This option is considered in more detail in Annex 2. Rather than increase support for one service only (as per education) this would allow the range of support to be spread more widely.

8.8. We believe that we do need to look again at the role of specific grants in the new local government finance system. There are clearly some policy objectives which may be best served by the provision of specific grants. Against that, we believe that we should use the opportunity to take another look at the present range of specific grants to see if any have outlived their usefulness.

8.9. To that end we propose a review of specific grants. This is discussed further in Annex 2. But we believe specific grants should be looked at on their merits, as ways of promoting central government policies, and not simply as a way of reducing the residents' charge.

8.10. Our conclusion is that none of these options is desirable. We do not believe it would serve accountability to further reduce the proportion of local authority expenditure funded locally, which all these options would do. The benefit would accrue disproportionately to the authorities which needed it least.

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8.11. We have looked therefore at options which would require the present level of local funding, but with reduced weight put on the residents' charge.

a. Locally variable sales tax

8.12. An average 4% local sales tax on top of VAT and with the same coverage could halve the required yield of residents' charge. Since the better off consume more goods liable to VAT, they would shoulder a greater proportion of the local tax bill; payment would be relatively painless and local authorities would have a buoyant source of income.

8.13. But on present local government boundaries, a locally variable sales tax is a non-starter:

- there are enormous variations in the volume of sales per head of population from one authority to another. (Manchester and Newcastle have over twice as much shopping floor space per person as Salford and Gateshead.) The yield of a sales tax would therefore vary so much from one authority to another that we would be bound to be driven into the complexities of an equalising grant. This would nullify the point of a locally variable tax;

- traders in high spending areas would be impotent and unwilling victims of cross border shopping;

- the tax would be enormously complicated and collection would be expensive for both business and government.

8.14. These arguments effectively rule out a local sales tax.

b. Locally variable Vehicle Excise Duty

8.15. We have looked at the option of allowing local authorities to levy a local VED on cars and light vans. The England only yield of the tax was £1.5 bn in 1984-5.

8.16. Although there would be some administrative cost in most parts of the country, a locally variable VED would be administratively feasible. But special arrangements would probably be needed in London, to allow a "greater London" rate of VED to be set and pooled.

8.17. Financing local authority expenditure partly from the residents' charge and partly through VED would produce a less regressive distribution of the tax burden than a pure residents' charge between households, since better-off households tend to own more cars. But the distribution of car ownership varies widely between authorities, from 0.41 per head in Hertfordshire to 0.20 per head in Tyne and Wear. Without a grant to equalise these disparities in car ownership, the rate of residents' charge authorities would have to levy for spending at assessed need would vary enormously from authority to authority.

8.18. We looked at an alternative whereby the proceeds of VED would be hypothecated to local authority roads expenditure. Again, however, there is no simple match between need to spend on local roads and the level of car ownership with roads expenditure per car varying from £148 in Northumberland to £48 in Greater London. Department of Transport estimated that a Transport Supplementary Grant of nearly £500 m covering both current and capital expenditure would be required to equalise VED rates for spending at assessed need.

8.19. We concluded that, despite the attractions, locally variable VED was not practicable because of the disparity in local yields.

d. A supplementary tourist tax

8.20. The role of a supplementary tourist tax would not be to reduce the general level of the residents' charge, but to compensate authorities with large tourist populations for any failure of the needs assessment to take account of the extra burdens they impose.

8.21. We considered a supplementary bed tax which local authorities could levy at their discretion. But an additional tax on tourism seems inconsistent with other recent initiatives to promote the tourist industry and would also add directly to business costs since it would be impossible to distinguish between businessmen using hotels and tourists using them.

8.22. We therefore concluded that we should rule out a supplementary tax on hotels and boarding houses. If colleagues want to provide additional revenue to authorities with largeconcentrations of tourists, our preference is to modify the non-domestic rate arrangements applying to hotels and boarding houses, such that the local authority retains part of the non-domestic rate (or collective residents' charge) payable on these properties.