From: The Rt. Hon. KENNETH BAKER, M.P.

HOUSE OF COMMONS
LONDON, SW1A 0AA

PM - to see.

28 January 1986

NBPM.

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Dear Margaret.

"PAYING FOR LOCAL GOVERNMENT"

This afternoon I made a statement in the House, launching our Green Paper "Paying for Local Government", which makes major proposals for the future financing of local government in Great Britain.

The Paper's central theme is the need to bolster local democratic accountability. To enable us to do this, we must find a way of paying for local government, which narrows the gaps between those who use, those who vote for and those who pay for local authority services.

There are three major sources of weakness in our present arrangements:

- Business and Commercial Rate payers foot 60% of the local tax bill but have no vote. For them, rates are an uncontrollable overhead which can and does vary from year to year;

- the unstable and complex way in which Government grants are paid, which obscures local accountability;

- the unfairness of rates, in that the rates burden is carried on too few shoulders. Of England's 35 million electors only 18 million are directly liable as ratepayers. In many authorities, well over 50% of the electors pay no local rates and therefore have little interest in their council's spending and rating plans.

Doing nothing is no longer an option. As this year's RSG settlement has shown, the present system is creaking under the strain, as we try to impose pressures on it that it was never designed to take. If we continue to care about local government spending we face a choice: greater control from the centre or radically improved accountability to make it work properly. In my view we have no option but to go for the latter.

/ This is the approach adopted in the Green Paper, of which I attach a summary. We are proposing:

- a uniform national non-domestic rate, determined by central government;

- the replacement of rates with a flat-rate community charge paid by all adults;

- a greatly simplified grant system.

These proposals amount to the most radical re-structuring of local government finance this century. Because of its importance we have allowed for a reasonable period of consultation.

It is very important for the Party throughout the country to discuss and examine these proposals. I and my fellow Ministers will be touring the country to describe the benefits of these proposals, at Party meetings and to listen to views. I do commend the proposals to you and hope that you feel able to support them, and speak in favour of them.

Kenneth

KENNETH BAKER

Rt Hon Mrs Margaret Thatcher FRS MP

THE GOVERNMENT'S GREEN PAPER

"Paying for Local Government"

1. Background

This Green Paper marks the conclusion of work on the Local Government Finance Studies which were announced at the Party Conference in October 1984.

2. Why Change the System? (Chapter 1)

Local Government is big business. It has nearly two million full-time, and one million part-time employees. It accounts for over a quarter of all public expenditure, and 11% of GDP. In 1984/85, the services provided by Local Government in Great Britain cost over £45 billion.

Rates account for 10% of all taxes levied, and another 16% of taxes are used to finance local authority expenditure through Government grants. The arguments against high levels of taxation apply just as much to local taxes as to national taxes.

Since 1979 the Government has tried to restrain local government expenditure by measures, primarily reductions in Government Grant. But this policy has revealed major weaknesses in the accountability of local councils to their ratepayers.

3. Non-domestic rates (Chapter 2)

* Non voting non-domestic ratepayers contributed nearly £8 billion towards local authority revenue expenditure in 1984/85 - more than a quarter of the total.

* Of the total rate income of English local authorities, over half comes from the non-domestic sector, under 40% from domestic ratepayers and the remaining 10% from rebates.

* On average for every £1 raised from domestic taxpayers, £1.50 is raised from the non-domestic sector.

* The poundages vary enormously from one part of the country to another - in England by as much as 113% as do the non-domestic rateable values. A third of England's non domestic rateable value is accounted for by London and half of that in London is concentrated in four central boroughs, meaning that a complicated redistributive mechanism is needed.

There are few taxes that could be substituted for the non-domestic rate, so as to abolish it altogether. A Payroll Tax, would be a tax on jobs and therefore unacceptable. The Government has also rejected replacing the yield of non-domestic taxes by increasing VAT or the basic rate of income tax. The Government does not wish to damage work incentives with the latter proposal.

Some advocate the re-introduction of the Business Vote which was eventually withdrawn in 1979. A large proportion of businesses are now limited companies, and trade in more than one local authority area. Satisfactory voting arrangements would be difficult to devise and would be regarded by many as an infringement of basic democratic principles.

Non-domestic rates fail the basic requirement of a satisfactory local tax: that those who pay it should be aware of who is levying it, and should be able to influence it's level.

The Government has concluded that non-domestic rates are not suitable as a locally-variable tax.

Proposals for Non-Domestic Rates

The Government proposes to remove non-domestic rates from the control of local authorities by setting a uniform rate throughout the country.

This would be set at a level sufficient to raise the same overall amount of income as the existing varying non-domestic poundages. The proceeds would be pooled nationally and redistributed to all authorities in a common amount per adult. The rate would continue to be collected by local authorities.

Businesses would be protected against subsequent increases by the indexation of the poundage to the inflation rate.

The proposals would provide more of an element of certainty for businesses, by removing the damaging variations in non-domestic rate poundages. They would also ensure a continuity of income for local government and permit a radical simplification of grant arrangments.

It would also prevent the weakening of local accountability that occurs when local authorities finance marginal increases in their spending, largely at the expense of non-domestic ratepayers.

It is important that the national non-domestic rate is levied consistently. There will be a revaluation of non-domestic properties in time to introduce new values on 1st April 1990.

The national poundage and the new non-domestic rateable values will both affect rate bills for businesses, so the Government would need to devise suitable transitional arrangements to phase in these combined effects over several years.

It is felt desirable to retain a link between local authorities and their non-domestic ratepayers. The Government proposes that there could be a limited discretionary local non-domestic rate - perhaps 5% of the national rate with the yield retained locally.

Conclusion

For businesses, the proposals offer certainty about future increases in non-domestic rates and should aid those planning investment decisions.

Local authorities will continue to enjoy collectively the non-domestic rate income bill will no longer be able to ask businesses in their areas to fund excessive spending.

4. Domestic Rates (Chapter 3)

There is a mismatch between those liable to pay domestic rates, those who benefit from local authority services and those who are entitled to vote in local elections.

Domestic rates take little account of the use of local services, such as education, social services and libraries, which are personal rather than property related.

The burden of rates falls onto too few shoulders. Only about 18 million of England's 35 million electors are liable to pay rates, and 3 million ratepayers pay no rates, due to rebates. Therefore local accountability suffers because those electors who do not receive rate bills will not bear the cost of their local authority's decisions, which they should weigh in their minds before voting. Any new tax should be widely based, giving as many electors as possible a direct financial interest in the decisions of their local authority. Obviously the more the burden is spread, the lighter it becomes individually. It should provide a clear link between changes in an authority's spending and the local charge.

Possible forms of Local Tax

The Green Paper examines the various alternatives to local rates which would be capable of raising comparable amounts of revenue.

- Local Sales Tax If this were levied on top of VAT, it would certainly have wide coverage but it would achieve little for local accountability since electors would not receive a direct charge.

It would entail considerable administrative complexity and its yield would be lumpy and fall unevenly. Differences in the amount of this tax from area to area could drive residents to shop outside their local authority.

- Local Income Tax This has a number of serious drawbacks:

  * Extending the taxation of incomes would run counter to the Government's commitment to reducing the burden of tax on incomes. With local as well as national income tax, the combined basic rate in some areas could be 40%.

  * A local income tax would do nothing to underpin local accountability. There are 20 million income taxpayers in England, compared to over 35 million voters. Whilst local income tax would widen the tax base, still only 57% of the electorate would pay a local tax.

* It would mean considerable administrative burdens falling on employers whose employees could live in different areas, with different rates of tax.

* Finally, income tax is not an appropriate tax for local authorities. They are providers of local services for which some form of a charge would be more appropriate. A redistributive and buoyant income tax with important national economic effects is not suitable.

The way forward: a Community Charge

The Government has concluded that the only suitable replacement for rates would be a flat-rate charge payable by all adult residents of a local authority - a community charge for local services, payable at the same rate by all the adult residents of a local authority.

* The Community Charge would be more perceptible than Rates, giving clear price signals to all local taxpayers.

* Each local authority would determine the level of it's community charge.

* All adult residents would be liable to pay, not just householders, which will greatly reinforce local accountability.

Moving from rates to a flat rate Community Charge would mark a major change in the direction of local government finance back to the notion of charging for local authority services.

At the lowest income levels, help would be provided through the social security system, although as proposed in the White Paper "Reform of Social Security" (Cmnd 9691), everybody would have to pay some of their local tax bill in order to promote local accountability.

A New Register

Local authorities would compile a new register of those liable to pay the charge, separate from the electoral register. Residence would have to be defined and people registered, who would include foreigners.

The costs of administering the new tax would be offset as the costs of running the present system, particularly the operations of the Valuation Office were reduced as authorities ceased to raise rates.

Transition

The move from Rates to a Community Charge will inevitably affect household finances since single adults gain at the expense of multi-adult households.

The Government feels the change must be made gradually by introducing the Community Charge initially at a low level. The Government's objective is to replace domestic rates entirely with 10 years of the introduction of a new system. To achieve this it will be necessary to require periodic transfers from rates to the community charge but some parts of England will require longer periods of adjustment so rates will take longer to disappear.

Summary

Taken together with the other proposals, the Community Charge would provide a clear link between local authority spending decisions and local tax bills. By widening the tax base to all adults the burden is spread, and local accountability enhanced.

5. Grants to Local Authorities (Chapter 4)

Rate Support Grant is paid to support local authority expenditure, and compensates local authorities for differences in the amount they need to spend to provide a comparable standard of service (their Grant Related Expenditure Assessment or GRE) and for differences in their rateable resources.

The existing system has undoubtedly weakened the accountability of a local authority to its ratepayers:

- The grant to an authority depends partly on their spending to the spending of the whole of local government and causes difficulties in predicting grant income and clouds the link between expenditure changes and changes in rates.

- Continued modifications have to be made to GRE's causing instability in allocating grant from one year to the next.

- The Equalisation of rateable resources transfers a large sum of money around the country, hidden with the grant system. In 1984/85 for example the South Eastern region lost £212 million, whilst Yorkshire and Humberside gained £329 million.

This has the effect of reducing rates bills in areas with low rateable values and produces variations in bills between authorities, even for comparable levels of service. For example, for a comparable standard of service, the occupant of the four bedroomed detached house in Carlisle would pay £550 a year, while his counterpart in Luton would pay £970. The resulting variations in rate bills greatly exceed regional variations in average incomes.

The Grant System has to be reformed if it is to make a contribution towards improved local accountability. It must be simpler, more stable and allow local taxpayers to see a direct and understandable link between changes in their local authority's spending and changes in their local tax bills.

Kenneth Baker MP, Secretary of State for the Environment said at the Party Conference on 9th October 1985 of the current system:

> "It is a maze surrounded by a marsh, enshrouded in a fog. We really have to find a simpler system. It has got to be overhauled."

Proposals for a new Grant System

The Government remains committed to compensating authorities for differences in the amount they need to spend to provide a comparable level of service.

Resources equalisation through the grant system is no longer needed. The proposals to pool and redistribute the yield of the non-domestic rate, and to replace rates by a flat-charge payable by all adults, would remove variations in authorities' taxable resources.

Ending resources equalisation, achieves two important objectives:

- it would ensure domestic taxpayers throughout the country would pay the same bill for spending at the level of assessed need.

- it would enhance accountability by removing a major distorting factor between marginal changes in expenditure, and local tax bills.

The Government envisages that the new grant system would consist of two components:

- a needs grant, which would compensate authorities for differences in their spending needs; the GREs which provide the assessment of those needs would be reviewed with a view to making them less complex and more stable;

- a standard grant which would distribute the remaining grant as a common amount per adult to all authorities.

There would be no link with actual spending levels. Allocations would be fixed at the start of the financial year and would not alter subsequently. This would provide a simpler system; give authorities greater certainty; and ensure that the full costs or benefits of increases or reductions in spending would be felt by local domestic taxpayers who, with the move to the community charge, would comprise all the electors of the authority.

The Government is undertaking a separate review of specific grants to establish the extent to which the continuation of existing individual grants, and the case for any new grants, is justified.

<u>The Combined effects of changes to local taxation and grant (Chapter 5)</u>

The tax and grant reforms would have important distributional consequences and cause significant changes in authorities income:

* Authorities spending at a low level in relation to their GRE's and those with high rateable values would tend to gain extra income. (Most are in southern, eastern and central England).

* Authorities who would stand to lose tend to have low rateable values, high spending mostly in northern England.

* High spending London authorities would experience significant losses in income.

Because these changes would be too disruptive, the Government is proposing special transitional arrangements to ensure that the effects on the vast majority of taxpayers would be very modest.

Capital Expenditure (Chapter 6)

The existing system has proved unsatisfactory and the Government are considering two possible reforms:

- a system of external borrowing limits which would impose limits on all borrowing, whether for capital or revenue by each authority. This proposal would have some practical difficulties.

- control of authorities' gross capital expenditure which would mean they were unaffected by receipts from the sale of assets for which an allowance could be made in their allocations. Although this reduces the flexibility open to authorities it is the more practical of the two approaches.

Other Financial Issues (Chapter 7)

Reforms in two other areas, could help electors see clearly the link between their council's spending and their payments for it:

- Sales, fees and charges

There is scope for more direct charging, improving charging practice and raising more revenue from fees and charges. The Government has therefore established a review of charging practice, reinforced by incentives to maximise income under the new grant regime.

- The Budgeting Framework

A few authorities have deliberately set rates which are inadequate to meet planned expenditure. The Government proposes to tackle this problem by placing a duty on each Treasurer to certify that his authority's proposed tax demand is sufficient to meet it's estimated expenditure.

Scotland and Wales (Chapter 8 and 9)

The proposals in the Green Paper take account of the somewhat different circumstances of England, Scotland and Wales. Wales has the same basic structure of local government finance as England, though the systems are administered separately and there are some minor differences. Scotland has separate legislative arrangements and had a rating revaluation in 1985. The Government's attempts to restrain local authority spending have been more successful in Wales than in Scotland or England. However, the same shortcomings in local accountability arise in all three countries and the main proposals for changes to domestic and non-domestic taxation and the grant system apply to the whole of Great Britain. The range of domestic rate bills is smaller in Scotland and Wales than in England; this should enable rates to be phased out more quickly in those two countries.

Conclusion (chapter 10)

The proposals in the Green paper would widen the tax base so that virtually all adults would have a financial stake in the affairs of their local authority. They would ensure that the full costs or benefits of any change in a local authority's expenditure would fall on its domestic taxpayers alone. While non-domestic ratepayer would still make a significant contribution to local government expenditure overall, authorities would no longer be able to finance extra expenditure by taxing them at their own discretion. Together these reforms would ensure that the accountability of local authorities to local electors and taxpayers would be greatly enhanced.

The Government invites comments on its proposals by 31 July 1986, except in respect of capital expenditure, comments on which are requested by 14 April 1986.

MR. NORGROVE

advised 20/1/86

Both the Chief Whip and Mr. Baker are resolved, as I think the Prime Minister knows, not to offer financial concessions tonight on the RSG order. Oliver Letwin and John Redwood believe, nevertheless, that concessions should be offered. No need to tell our boss at this stage, but you may get a note transmitted to you for the Prime Minister.

(NIGEL WICKS)

20 January 1986

P.S. The view of the Departmental Minister, Mr. Baker, and the Chief Whip is that no concessions should be given. Statement being made at 3.30 our time, so PM needs to see quickly.

NW

Telephoned to PPS party.

N.L.W.
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MR WICKS

20 January 1986

RATE SUPPORT GRANT

It has always been clear that the Shires would suffer from the proposed RSG settlement, and that this would cause a fuss. The signs are that the fuss will be, if anything, greater than expected.

In the political mood of three weeks ago, it would have been enough to promise a better year in 1987/8 and to talk about the ending of hold-back. There would have been some votes against and a minor row, but life would have moved on.

In the week after Heseltine, things are different. Morale is low in the Party and another group of half-hearted backbenchers talking the Government down to the Press is dangerous. Although the vote will still be won, the revolt will be a further blow to morale. The press will love every minute of it.

Why not add to the statement a small cash sweetener for those Councils that have controlled their spending well, to let the backbenchers and the Party feel that their representatives have some impact? The amount need not be great, but it will give the backbenchers something to take back to their Councillors.

OLIVER LETWIN

JOHN REDWOOD