

CONFIDENTIAL

GCBG



Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Kenneth Baker MP
 Secretary of State for the Environment
 Department of the Environment
 2 Marsham Street
 London
 SW1P 3EB

N BPN

26 March 1986

Dear Kenneth,

LOCAL AUTHORITY CONTRACTING OUT

Thank you for your letter of 7 March.

at trap

In view of the fact that legislation is on its way I am content to accept your view that issuing a White Paper this summer would not achieve very much. I am glad that you and William Waldegrave will be pressing the theme of competition in other ways whenever opportunity offers.

We do, of course, still need to decide whether or not to modify the proposals set out in the February 1985 Green Paper on Competition in the Provision of Local Authority Services in the light of comments received. I understand that you aim to put a paper to H Committee shortly, and I look forward to seeing your suggestions.

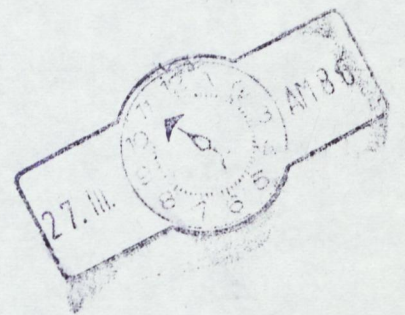
I am copying this letter to the Prime Minister, the Lord President, and other members of H Committee and to Sir Robert Armstrong.

Yours ever,

JOHN MacGREGOR

CONFIDENTIAL

LOCAL GOVT Relation P120



CBB



2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref: B/PSO/11156/86

Your ref:

7 March 1986

NSM

Mr Tom,

LOCAL AUTHORITY CONTRACTING OUT

Thank you for your letter of 4 February. You also referred briefly to this subject in your letter of 18 February about the RSG Settlement.

As you know, Cabinet has now agreed that we should legislate in 1986/87 to extend competition in the provision of local authority services. My officials are working up detailed proposals as quickly as possible, with the aim of introducing them at the beginning of the session.

Local authorities are already well aware of our views and intentions because of last year's consultation paper. This was a clear statement of the Government's policy, with only green edges so far as the extension of competition was concerned. I therefore do not think that issuing a White Paper this summer would achieve much. On the other hand, it would divert my officials from the task of preparing the legislation, and there would be a danger of creating hostages to fortune as the subject is so complex. We do not want to promise detailed legislative changes which, in the event, prove impossible to draft.

I therefore propose that we continue to press the competition message in other ways. I, and I am sure your colleagues with an interest in local government spending, will continue to emphasise its importance in speeches. William Waldegrave is opening a 3 day local government conference on competition in April, which will also be addressed by Jack Cunningham and other leading opponents of competition. That will provide a very good opportunity for setting out our intentions.

As I said in my letter of 7 January, we are also considering using consultants to prepare general advice on the practical process of tendering in the new areas, so as to enable us to implement the legislation quickly.

We shall be including provisions in next Session's Bill to tighten up the existing DLO regime. In the meantime, I know that

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LOCAL GOVT
RELATIONS Pt 29

Nicholas Ridley is about to consult on proposals which should more than double the amount of highways maintenance work which has to be put out to competition.

I believe that all this adds up to a very good public presentation of the benefits of competition in local authority services.

I am copying this letter to the Prime Minister, the Lord President, and other Members of H Committee and to Sir Robert Armstrong.

Tommy
Kenneth Baker

KENNETH BAKER



The Rt Hon John MacGregor OBE MP

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CONFIDENTIAL

CCRB

FROM THE MINISTER FOR LOCAL GOVERNMENT AND THE ENVIRONMENT



SCOTTISH OFFICE
NEW ST. ANDREW'S HOUSE
ST. JAMES CENTRE
EDINBURGH EH1 3SX

The Rt Hon Kenneth Baker MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
LONDON
SW1P 3EB

10 February 1986

NBP7

D. Kenneth,

LOCAL AUTHORITY CONTRACTING OUT

I read with interest John MacGregor's letter of 4 February circulated to the Prime Minister and to members of H Committee.

I very much hope that it will prove possible to take a competition Bill next session. Left to themselves, local authorities show little or no inclination towards increased competition; and we must therefore do all we can to induce in authorities a more positive attitude to greater efficiency and effectiveness. There are, I am sure, significant savings to be made either by having work done in the private sector or because of the stimulus of competition on the local authorities' own workforce: and these savings in turn open the way to rate reductions without any reduction in the standard of the services involved.

The proposal for a White Paper in the summer also has my full support as I think it is important for us to take every opportunity to publicise our commitment to further tendering for a wider range of local authority activities and to the introduction of legislation on this subject at the earliest opportunity. I would hope that Scotland would be seen to be involved in this process in a significant way; and my officials will be working closely with yours on the detailed proposals over the months ahead.

I am copying this letter to the Prime Minister, to the Lord President, members of H Committee and to Sir Robert Armstrong.

Yours
Michael

MICHAEL ANCRAM

LOCAL GOVT
RELATIONS
PT 29



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CC BG

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Kenneth Baker MP
 Secretary of State for the Environment
 Department of the Environment
 2 Marsham Street
 London
 SW1P 3EB

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 4 February 1986

Dec Kenneth,

NBM

LOCAL AUTHORITY CONTRACTING OUT

Thank you for your letter 7 January. ^{at Pap}

I welcome your assurance that officials are doing the detailed work so as to be ready with instructions to Counsel at short notice. As you say we do need to demonstrate to the world that we are actively preparing the legislation. If, as I hope, QL Committee and Cabinet endorse your bid for legislation on this in 1987-88, it might help if you could produce a White Paper in the summer setting out the results of last year's consultations and the Government's decisions on the scope of the legislation to be presented in 1986-87.

I agree with your other suggestions for non-legislative measures. Practical advice on tendering in the new areas will be particularly useful. The better the tendering process the more likely is it that value for money improvements will be achieved.

I am copying this letter to the Prime Minister, to the Lord President, other members of H Committee and to Sir Robert Armstrong.

Yours ev,
 JH

JOHN MacGREGOR

LOCAL GOVT P129

Relations



Paying for
 Local Government

PROPOSALS FOR CHANGE



Department of the Environment

Cf please pa.
 (dated Jan 1986)

A MESSAGE FROM THE SECRETARY OF STATE

Your local council is elected to provide a vast range of services. Everyone in your area benefits, directly or indirectly, from those services.

That makes local government big business. In 1984/85 councils spent £45 billion – a quarter of all public spending. They employed nearly three million people – one-seventh of the country's workforce.

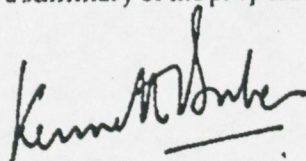
Expenditure on such a huge scale has to be a matter of serious concern to all; to Government because of our responsibility for the national economy; to local authorities because they spend the money; and most importantly to you the taxpayer and the ratepayer because it is **your** money.

Local government has no money of its own. Someone has to provide it. The domestic ratepayer knows only too well how much he pays. But few realise that the taxpayer pays for half of local spending through central government grants. Fewer still know that the business ratepayer provides two-thirds of the rest. And practically nobody understands how the system of government grants to local authorities works.

The result is that people don't know why they pay what they do for local services or why their rates go up or down or why they are higher or lower than in another local authority area. What they do know is that very many people benefit from local services but make no contribution at all.

The present system is unsatisfactory. Virtually everyone accepts that what is needed is a system which is both fair and comprehensible. That is why the Government has carried out a searching review of how we pay for local government. Its conclusions and proposals for change have been published in the Green Paper, *Paying for Local Government*. The Government is now inviting everyone who will be affected by the proposals – local electors and ratepayers, industry and commerce, and local government itself – to comment on those proposals.

To help the process of consultation this leaflet is intended to provide a summary of the proposals and the reasons for them.



KENNETH BAKER
Secretary of State for the Environment

PAYING FOR LOCAL GOVERNMENT THE NEED FOR CHANGE

At present, local government spending consumes about a quarter of all taxes paid in the United Kingdom.

That level of spending and the burden it imposes on taxpayers cannot be ignored by central government. Since 1979 the Government has tried to encourage local councils to curb their spending. To do this it relied upon local ratepayers' reluctance to pay high rates to persuade councillors to keep spending down.

There has been some success in containing the growth of local spending. But serious flaws in the way we pay for local government have come to light. These flaws distort the impact of a council's

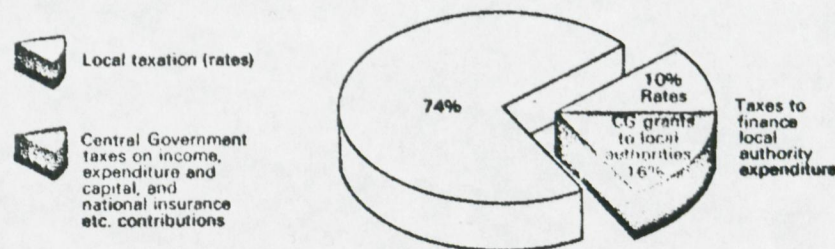
spending decisions on local electors and so weaken local democratic pressures against high rates. The main reasons for this are:

business ratepayers who do not have a vote pay well over half the extra rates needed for any increase in local spending;

only just over half of the local electorate are liable to pay rates;

the system of grants from the Government is so complex that local electors are not aware of the real costs of local services, nor can they see any clear link between changes in what their councils spend and changes in their rate bills.

LOCAL AUTHORITIES' CLAIM ON THE TOTAL TAX BURDEN
UNITED KINGDOM 1984/85



BETTER LOCAL ACCOUNTABILITY

Centrally government has a responsibility to manage the nation's economy. It also has to lay down policies and priorities for public services which are provided locally but where there is a national interest in standards.

Local government's role is to provide services in a way which reflects local circumstances and local choice. So government grants and local taxes should be designed in a way that makes local electors aware of the real costs of services.

Effective local accountability must allow local electors to decide the level of services they want and how much they are prepared to pay for them.

The Government believes the present system of local government finance weakens local

accountability. Because the cost of extra spending is not clear to local electors, councils may be tempted to increase spending rather than hold down rates.

One answer to the problem might be for the Government to take over the funding of key services – such as education – by transferring the costs from local ratepayers to national taxpayers. But this would reduce local discretion and increase direct interference from Whitehall. The Government rejects this approach.

The Government's preferred approach is to reform our system of local government finance so as to make sure that local accountability works properly. That is what the proposals in the Green Paper are designed to achieve.

THE GOVERNMENT'S PROPOSALS

The main proposals in the Green Paper are:

a uniform national non-domestic rate set by Government, with the proceeds distributed to all local authorities in proportion to the numbers of adults in their area;

a phased replacement, over a period of up to ten years, of domestic rates by a community

charge which each authority would set and which would be paid by every adult resident in its area;

a much simplified grant system, which would compensate for differences in local authorities' needs and provide additional help in the form of a flat-rate sum per adult.

The Government believes that these proposals would:

protect non-domestic ratepayers;

give all electors a stake in their council's finances;

ensure that the full cost of extra spending by a council is met by its own electors;

enable electors to see the link between what they pay and what they get;

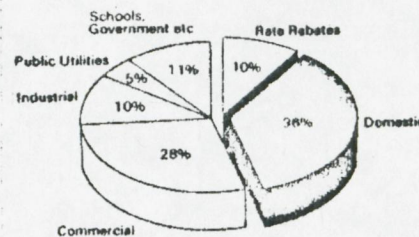
give local authorities greater certainty about the level of grant they will get.

The present system, for all its shortcomings, has been built up over many years. The Government accepts that changes cannot be made overnight. The Green Paper, therefore, proposes a phased move towards new arrangements.

NON-DOMESTIC RATES

In 1984/85 non-domestic rates – that is the rates paid by industry, commerce and institutions – contributed over £7 billion towards local spending in England. Over half the total rate bill comes from this source.

SOURCES OF RATE INCOME – ENGLAND 1984/85



Disadvantages of the present system

Non-domestic rates are not a satisfactory local tax for several reasons.

First, the size of the non-domestic ratepayers' contribution means, on average, they contribute £1.50 for every £1 paid by the domestic ratepayer – yet they have no vote or sanction over how much the council spends. The domestic ratepayers – who do have the vote – meet less than half the rates bill. This is unfair to businesses and weakens the accountability of councils to local electors.

Second, non-domestic rate poundages vary enormously from one part of the country to another – in 1985/86 from 151p in the £ to 347p in the £. These variations – which are caused by local authority spending policies over which the non-domestic ratepayer has no control – damage economic efficiency and distort competitiveness.

Third, the cost of non-domestic rates is ultimately passed on – for example through higher

prices – to people who may well not live in the area. So the effects of high rates on businesses do not necessarily fall on those who voted for high spending.

Fourth, non-domestic properties are heavily concentrated in particular areas. This means that there are major differences in the amount of income authorities can raise through the rates. Complex government grant arrangements are needed to even out such differences. This weakens the link between changes in spending and changes in local taxation.

Proposed system

To tackle these problems, the Green Paper proposes:

- a uniform national non-domestic rate, set by the Government;
- income from non-domestic rates should be pooled and distributed to all councils as a common amount per adult;
- increases in the non-domestic rate should be tied to the rate of inflation;

local councils should have discretion to set a local non-domestic rate up to a limit of, say, five per cent of the national uniform rate, and keep the proceeds.

Before the new system is introduced there would be a revaluation of non-domestic properties in time to introduce new values on 1 April 1990. There would be arrangements to phase in the effects of both the revaluation and the move to the national non-domestic rate, because local businesses will have to be protected from sudden changes.

The Government believes that this approach would:

- increase local accountability;
- remove the economically damaging variations in business rates;
- provide greater certainty for businesses;
- ensure continuity of income for local councils;
- allow a radical simplification of the grant system.

DOMESTIC RATES

Yardsticks for a local tax

The Government considers that any local tax must satisfy three main tests:

- is it technically adequate?
- is it fair?
- does it encourage local democratic accountability?

Each of these tests is important. But the test of encouraging local accountability is crucial.

Disadvantages of domestic rates

Although domestic rates are technically well tried and tested,

the Government believes that they fail the other tests:

they take little account of people's use of services;

it is almost impossible to see any relationship between changes in rate bills and changes in council spending;

rates fall on too few shoulders.

Only 18 million of the 35 million electors in England are liable to pay rates. About three million of them have their rates paid in part by rate rebates, and a further three million have their rates paid in full.

These factors mean that councillors cannot be clearly accountable to their electors for their spending decisions. Part of the problem will be tackled by the Government's proposal in its review of the social security system to make all ratepayers pay at least 20 per cent of their rates bill. But this reform will still leave

almost half the electorate paying no rates; and it will not deal with the underlying weaknesses of the domestic rating system.

The Government has therefore concluded that domestic rates must be replaced by a new local tax if local accountability is to be improved.

Alternatives to domestic rates

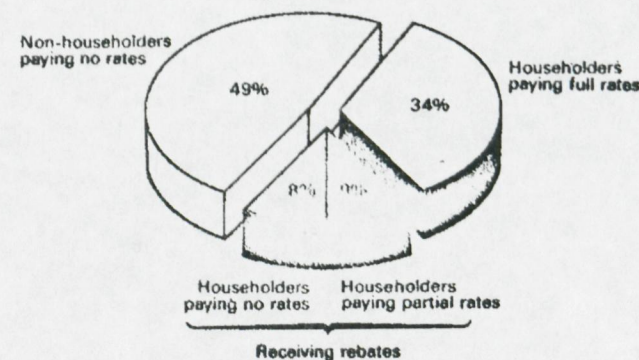
There are only three types of tax which would be capable of raising the amount of revenue currently produced by domestic rates:

- a local sales tax;
- a local income tax;
- a tax on residence – a community charge.

A local sales tax

To produce the income currently raised by domestic rates a local sales tax would have to be levied at an average rate of 6½ per cent on top of VAT. But it would not be workable within the British

PROPORTIONS OF THE ELECTORATE PAYING FULL OR PARTIAL RATES
ENGLAND 1984/85



structure of local government. And while it would be paid by all consumers, it would be administratively complex and its yield would be very uneven between councils.

Above all, it would not enable local people to see a clear link between what they paid in local taxation and the spending behaviour of their local council. Sales tax therefore fails the key test of promoting local accountability.

Local income tax

To produce the income currently raised by domestic rates would require, on average, an increase of 4½p on the basic rate of income tax. Although local income tax is widely advocated as an alternative to domestic rates, it has serious disadvantages:

higher income tax would run counter to the Government's commitment to reduce the burden of tax on incomes;

a local income tax – paid by less than 60 per cent of the local electorate – would not greatly increase local accountability or tie payment for local services more closely to the use made of them;

a tax which redistributes income has important implications for the management of the economy and so is not a suitable tax for local councils;

even though PAYE income tax is now being computerised, there would still be great administrative difficulties in running a local income tax.

A tax on residence – A community charge

The Government has, therefore, concluded that the only suitable replacement for domestic rates would be a flat-rate charge payable by all adult residents – a community charge. Alone of the options, it satisfies all three of the main tests for a local tax. Help to those on low incomes would be provided through the social security arrangements.

The Government believes that:

the community charge would be better related to use of local services and would greatly increase accountability because everyone would have to pay something;

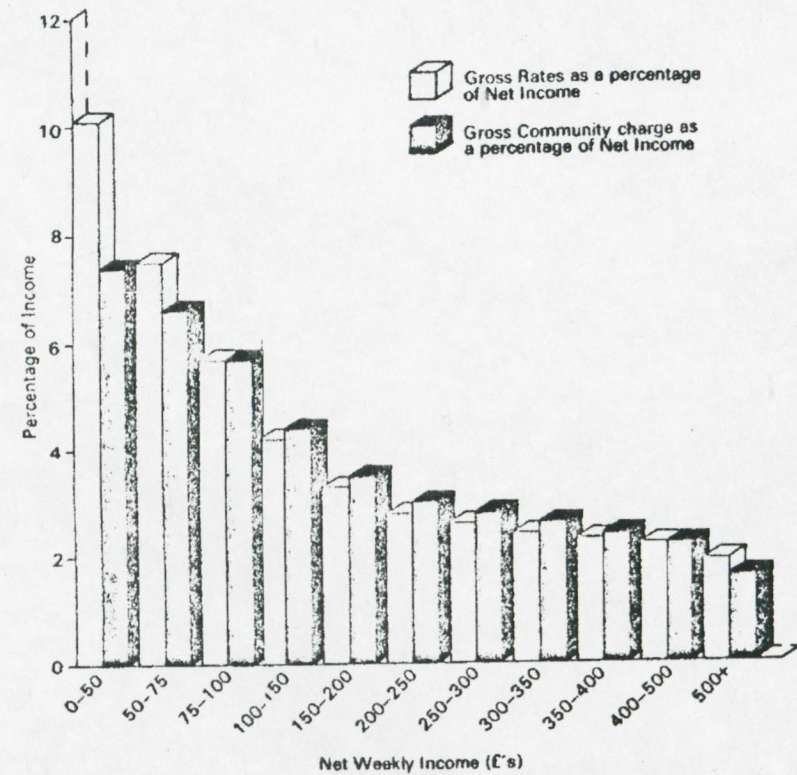
it would be at least as well related to ability to pay as domestic rates;

the poorest households – those with an income (after taxes) of less than £75 a week – would, in general, be better off, as the chart opposite shows; this is because many of them are single-adult households.

Register

The proposed new system would require councils to set up a new register of those liable to pay the community charge. This would be separate from the electoral register and would include foreign residents and others not eligible to vote.

RELATIONSHIP OF RATES AND FULL COMMUNITY CHARGE
– BEFORE REBATES – TO NET HOUSEHOLD INCOME
IN GREAT BRITAIN



GRANTS TO LOCAL COUNCILS

The present system

About half of local revenue spending is paid for by the national taxpayer through Government grants. The main grant – block grant – is designed to iron out differences in the income local councils can raise from rates and differences in what they have to

spend to meet their local needs and circumstances.

The present system, however, undermines the accountability of councillors because it obscures the link between what councils spend and what they ask their ratepayers to pay. It is very difficult to work out

whether increases in rates are caused by the spending policies of the council or by factors outside the council's control, and to understand why rate bills vary so much from one authority to the next. In addition, councils cannot be certain what their income from government grant is going to be.

These problems arise because:

councils find it very difficult to predict how much grant they will get because this depends not only

on what they spend but on what other councils spend;

changes in the way in which grant allocations are calculated make for constant instability in the system;

the process of trying to compensate for differences in how much councils can raise from rates transfers large sums of money round the country in a way that nobody understands. It also produces wide variations in

average domestic rate bills between councils, even for comparable standards of services, as the chart on the left shows.

All these factors obscure the link between changes in spending and changes in rates.

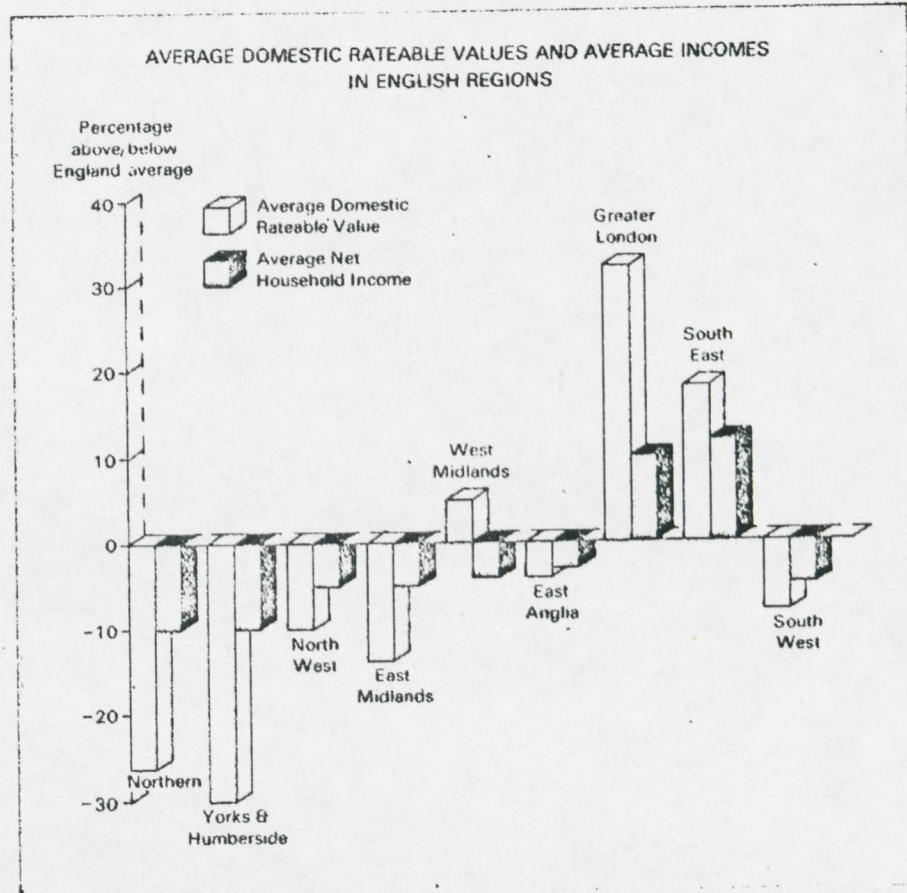
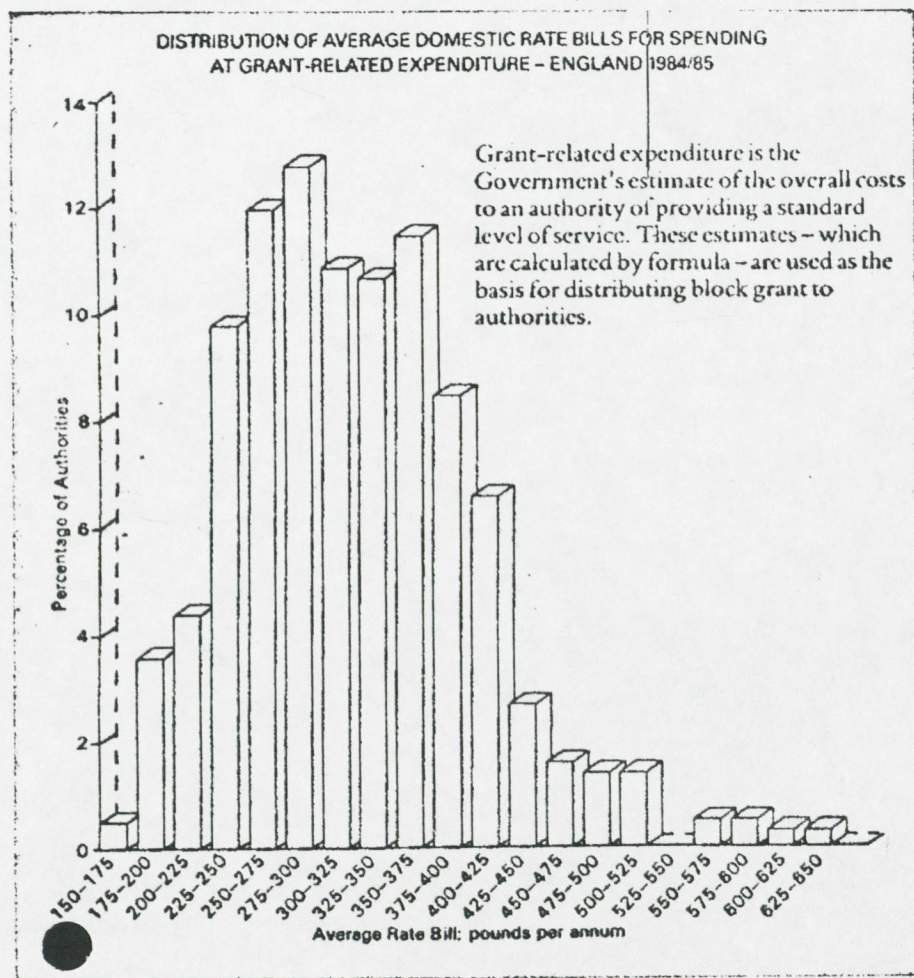
The grant system also has other undesirable effects. It leads to variations in average domestic rate bills between areas which are far greater than the variations in average incomes.

The chart below shows the large variations in domestic rateable values in different English

regions – one of the factors determining the distribution of Government grants and the level of rate bills – when compared with variations in average incomes. This can encourage ratepayers in areas with low rateable values to demand higher spending on services than those in areas of high rateable values.

Proposed system

The Government believes the grant system must be reformed if it is to help improve local accountability. It needs to be



simpler and more stable and to allow local taxpayers to see a clear link between changes in what their council spends and changes in their local tax bills.

The Government will continue to compensate authorities for differences in their spending needs. But the proposals for reforming non-domestic rates and for replacing domestic rates with a flat-rate community charge mean there would no longer be a need to compensate for differences in authorities' ability to raise local income.

This paves the way for a simpler grant system, consisting of:

- a needs grant, which would compensate authorities for differences in what they need to spend to provide a standard level of service;

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

Grant allocations would be fixed at the start of the financial year and would not be affected by what councils spent.

The Government believes these proposals would:

- provide a much simpler grant system;

- give councils certainty and stability about their grant allocations;

- put the full costs or benefits of increases or reductions in a council's spending squarely on its own electors through the community charge;

improve the accountability of councils to their electors.

A BETTER SYSTEM

The Government believes that the proposals offer the promise of a fairer and better way of paying for local government. That means a system which will give stability to local councils; benefit the business ratepayer; and make it clear to voters what they are paying for the services they receive. That way they can decide what sort of council they want.

MAKING THE CHANGES

The Government will be considering any comments the public may have on these proposals. A White Paper will be published early in 1987 which will set out proposals for legislation.

YOUR VIEWS

If you want to make any comments on these proposals as they affect England, you can do so by writing before 31st October 1986 to:

*The Department of the Environment
Room N6/09
2 Marsham Street
LONDON SW1P 3EB*

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SG

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CC 130



2 MARSHAM STREET

LONDON SW1P 3EB

01-212 3434

My ref: B/PSO/19747/85

Your ref:

MBAN

7 January 1986

In Reply

LOCAL AUTHORITY CONTRACTING OUT

FLAP PT 29

Thank you for your letter of 29 November. I am glad we are agreed on the inadvisability of going for anything less than fully detailed legislative provision in this area. In anticipation of time being made available next session my officials are indeed continuing to make progress with detailed work, so as to be ready with instructions to Counsel at short notice.

The savings identified in John Banham's presentation do of course range well beyond the areas which would be directly affected by our compulsory competition proposals. Whilst I have no doubt that those proposals will achieve real savings and increased efficiency in the affected areas I think that we need to tread somewhat carefully in identifying the Audit Commission value-for-money studies directly with contracting out.

I will meanwhile consider what non-legislative measures might be taken. Like you I am anxious that the inevitable delay in legislation should not be taken as any weakening of our resolve to see a significant increase in competition within local authority services. In my view, therefore, we should concentrate on demonstrating to the public generally and the local government world in particular that we are actively preparing both the legislation and the more detailed service by service implementation proposals. A pilot project in one of the relevant areas of activity is one possibility; others might include overt joint working with, eg. CIPFA on financial issues and, perhaps through consultants, the preparation of some general advice on the practical process of tendering in these new areas.

I will certainly consider whether such proposals might usefully be brought to H. I am sending copies of this letter to the recipients of yours.

A handwritten signature in dark ink, appearing to read 'Kenneth Baker', with a horizontal line underneath.

KENNETH BAKER

John MacGregor Esq OBE MP

LOCAL GOVT
RELATIONS
PT 29

