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PART A

Part. A.

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PART. A.

Chancellor's (Lawsons) Papers: Local Authority Capital Expenditure and Rate Settlements 1989.

DD's: 25 Years

[signature]

24|1|96.

lg1.va/potter/minutes/LAce.cond

CHIEF SECRETARY

FROM: B H POTTER

Date: 2 February 1989

cc: PS/Chancellor
Sir Peter Middleton
Mr Anson
Mr Monck
Mr Phillips
Mrs Case
Mr Edwards
Mrs Lomax
Miss Peirson
Mr MacAuslan
Mrs Butler
Mr A White
Mr Wood
Mr Laite

Ch/ For info.

@15

Cl

No need to wade through all this.
Paras 1-11 are a useful description of a new system
Para 41 is worrying but unsurprising
Paras 52-56 indicate major row in prospect with Depts & LAs.

AA

LOCAL AUTHORITY CAPITAL EXPENDITURE: 1989 SURVEY

I attach a submission on the conduct of the 1989 Survey for local authority capital expenditure. I apologise for its inordinate length. But it is designed to set out in detail how local authority capital will be handled in the negotiations with Departmental Ministers in the 1989 Survey.

2. You may find a brief guide helpful. Section A describes the background to the new capital finance regime and the new planning total. You may wish to take that as read and focus instead on section B. It is this section which describes the Survey arrangements envisaged for 1989. Section C on setting the baseline is essentially covered in the draft letter to the Environment Secretary and can therefore perhaps be skimmed through. Section D is important however: this describes the main proposals for handling the first steps.

3. I imagine you will wish to discuss this submission with us.

Barry H. Potter

BARRY H POTTER

CONFIDENTIAL

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LOCAL AUTHORITY CAPITAL EXPENDITURE: CONDUCT OF 1989 SURVEY

This submission (agreed with GE) puts forward proposals for handling the 1989 Survey for local authority (LA) capital expenditure in England and setting the baselines. I fear the subject is very difficult but important: you will probably wish to talk it through with LG and GEP (and possibly HE and ST also).

2. By way of background, Section A first describes the post 1990 capital finance regime for LAs; explains the proposed treatment of LA capital spending within the new planning total (NPT); and draws attention to what the various interested parties - Treasury, spending Departments and LAs - will be looking for from the revised public expenditure planning arrangements.

3. Section B then considers how the various steps in the 1989 Survey on LA capital can best be organised - baseline, bidding process and negotiations - and what supporting information is needed to ensure a fair and orderly Survey.

4. Section C puts forward specific proposals on the first of these steps - setting a baseline. Finally Section D describes a number of handling issues and provides a draft letter for you to send to the Environment Secretary, setting out proposals on the conduct of the Survey.

SECTION A: THE NEW CAPITAL FINANCE REGIME AND THE NEW PLANNING TOTAL

New Capital Finance Regime

5. From 1 April 1990, a new capital finance regime for the main LA services (education, housing, transport, personal social services and other services) will be introduced in England and Wales.

6. The present capital control regime seeks to control total LA capital expenditure directly. The new regime focuses on the sources of finance for capital spending as follows.

(A) **CENTRAL GOVERNMENT**

(i) Credit Approvals (CAs): central government permissions for an individual LA to borrow or raise other credit.

(ii) Government grants: capital grants from central government and from the EC to finance capital spending.

(B) **LAs OWN SOURCES OF FINANCE:**

(i) Revenue contributions (RCCOs): LAs may pay for capital spending from revenue contributions; although rccos will not be controlled they will be subject to the accountability of the Community Charge.

(ii) Capital receipts: local authorities will be required to set aside 25% of their Housing receipts and 50% of other capital receipts from asset sales for debt redemption. The remaining balance will be available to finance new capital spending.

7. In each year each LA will receive a share of the available central government resources under (A) - the permissions to borrow (CAs) and capital grants. But, subject to the general restrictions noted above, each LA will be able to spend whatever its judges appropriate using the supplementary sources of finance in (B).

8. An objective of the new proposals is that the share of central government resources made available, in the form of credit approvals for each LA (Ai) should be more closely matched to the individual authority's financial as well as its real needs. For this reason the availability of receipts to finance the LAs capital programme will be taken into account (RTIA)* when distributing the CAs. The mechanism adopted is that a percentage of the capital receipts available to be spent will be added to the CAs total to form an Annual Capital Guideline (ACG). For each service block (ie education; housing etc), it is the ACG which will be distributed according to a central government generalised needs index (ie real needs) to the authority.†

* Receipts Taken Into Account

9. It is the CA that conveys permission to borrow. ACGs and RTIAs are essentially accounting devices to arrive at an appropriate level of CAs for each authority, given its access to accumulated receipts. ACGs also provide an indicator of the Government's view of each LA's relative needs as between services.

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†This of course contrasts with the present system for distributing capital allocations: by service these are allocated to each LA according to real needs, with no account being taken of the different access to spending power available from receipts.

10. Each LA will therefore receive its share of the central government resources through an ACG for whatever service blocks are relevant. Deducted from its total ACG will be its own receipts to be taken into account (RTIA), leaving a block (ie unhypothecated by service) credit approval. An example might be for a typical English district.

		£m
ACG for Housing	=	3
ACG for Other Services	=	2
		5
RTIA		1
Block Credit Approval		4

New Planning Total

11. Under the new planning total, only those elements of public expenditure within the responsibility of central government are included within the NPT. In the case of local authority capital expenditure, that is those in category (A) ie credit approvals (Ai) and central government (and EC) grants (Aii). LA capital expenditure financed from own sources of finance (B) will not be in the NPT, but will be within general government expenditure (GGE). (Changes to the planning total have no impact on GGE which continues to include all LA expenditure.) These own sources of finance are whatever spending LAs in aggregate choose to finance from extant capital receipts (Bi) (once the required percentage has been set aside for debt redemption) and any revenue contributions to capital outlays (Bii).

12. At the outset, it may be helpful to highlight certain features of the combined effect of the new capital finance regime and the introduction of the NPT which are particularly important for future public expenditure planning on local authority capital.

i) In future, there will be no accepted measure of the absolute need for capital spending. At present, gross provision (which included all sources of spending on LA capital) could be said to represent the level of the total need to spend on each main service accepted by the Government in any year.

ii) It will, however, be necessary to project likely LA capital spending financed from own resources (B) in order to derive a forecast of GGE. This projection when added to (A) the central government resources provided for spending on LA capital, will enable a forecast of total LA capital expenditure to be made.

iii) The Annual Capital Guideline (ACG) for each service will be a measure of the Government's assessment of relative needs as between service blocks - not absolute needs. In 1990-91 it will cover only about 60% of likely total spending: spending from capital grants, rccos and from receipts not taken into account will make up the remainder; and the allocation of this spending amongst services will be a matter for LAs. So it will not be possible to arrive at an accurate forecast of total spending by service block.

iv) The ACGs are important in two respects. First, for the individual LA level, they determine its share of central government resources. Moreover each LA may feel obliged to spend up to the ACG on each service (as they do at present with capital allocations): the ACG would thus form a floor on its service spending. Second ACGs are likely to be important to an individual Department. Even though they cover only around 60% of total spending, they represent a floor on total service spending; and aggregate ACGs will reflect Government priorities as between services over the resources they direct.

v) ACGs however are <u>not</u> meaningful at the total level across all services. They do not represent total needs <u>or</u> total central government resources <u>or</u> total spending.

vi) Local authorities will receive an unhypothecated block credit approval. It will be up to them to determine how it should be spent as between services. This might bear little resemblance when aggregated across all LAs either to the service distribution of ACGs or to the CAs by service.

13. It is also instructive to consider what concepts the main parties will be focussing on in the public expenditure planning process.

14. For the <u>Treasury</u>, most important will be the total CAs (and to a lesser extent the distribution) and provision for capital grants, particularly for 1990-91, but also for the two forward years. The Treasury will also be interested in the forecast of total LA capital spending which will be part of GGE.

15. For <u>individual service Departments</u>, attention is likely to focus on the ACGs by service (and capital grants to a lesser extent). They will regard figures for the CAs by service mainly as an input into the ACGs. As always, interest will mainly be on the first year: but they will also wish to seek high provision for the forward years. Moreover Departments are well aware that the ACGs cover only about 60% of likely total LA spending. In presenting the outcome of the Survey, they will also wish to give some indication of the likely total capital spending on their particular service, at least for the year ahead.

16. For the <u>individual local authority</u>, the ACG as a service planning indicator will be relevant; but in practice, it will be less important than the block credit approval - the amount of new borrowing permitted by central government. Local councils will want some indication of the resources available to them in the two forward years for capital programme planning purposes. Such an undertaking was given in the consultation document.

SECTION B: THE SURVEY PROCESS

17. Against that background, and in particular what the main parties will be looking for from the revised public expenditure planning process, the Survey arrangements must enable decisions on the following for 1990-91:

- CAs and capital grants by service block (and by department) since these are components of the NPT and must be reported to Parliament;

- RTIAs, so that the ACGs by service block can be determined;

- ACGs, so that block credit approvals can be issued to each local authority.

For the two forward years, at a minimum it will be necessary to establish provision for CAs and capital grants. Finally, in order to project total GGE, it will also be necessary to forecast likely spending on LA capital for all three forward years.

18. The remainder of this section considers how efficient Survey arrangements can best be put in place to meet the above requirements.

Objectives

19. A number of objectives for an efficient 1989 Survey can be identified. First there must be a stable and orderly framework within which Departmental Ministers can negotiate with Treasury Ministers over the central government resources for LA capital expenditure ie credit approvals and capital grants. That requires an agreed and well-understood framework for the Survey steps - fixing of baselines; the invitation of bids; how bids are to be prepared; the timing and content of the negotiations; and the arrangements for the presentation of the Survey outcome.

20. Secondly the negotiating framework must be consistent with the constraints of the normal Survey timetable. Thirdly, in the transitional Survey, it will be necessary to avoid setting any unfortunate precedents for the conduct of future Surveys.

Survey framework

21. Discussions with departmental officials have agreed the basic negotiation framework. It would be sensible to retain the present bilateral mode, with Departmental Ministers negotiating separately for the central government resources in terms of credit approvals and capital grants for their individual services. (At a later stage it may be desirable to reorganise the service blocks but for the remainder of this submission it is assumed that the existing five blocks will be retained.) It is the decision on credit approvals for each service block which will form the base for the Annual Capital Guidelines that each Department will issue to the relevant local authorities. Thus there will have to be separate baselines for each service block; separate bids; and separate bilateral negotiations.

22. You wrote on 13 January proposing that at least for the transitional Survey, credit approvals should be the main "currency" of the negotiations (alongside capital grants). They are preferable to using ACGs because CAs are the borrowing measure referred to in the proposed legislation; they are simple and broadly comparable to the existing Survey currency of capital allocations; they will feature directly in the new planning total; and they will influence the LABR directly. The Transport, Home and Education Secretaries have now written accepting this for the 1989 Survey.

23. Your letter also included a timetable for the Survey which has also been accepted: the main steps are as follows:

TIMETABLE FOR LA CAPITAL

Baselines	February	i)	set baselines for capital grants and credit approvals for 1990-91 and 1991-92 on provisional assumption about receipts;
		ii)	set a provisional assumption about RTIA for 1990-91;
	April	iii)	finalise baselines in the light of latest data on receipts;
		iv)	create baseline for 1992-93;
Bidding	May	v)	invitation to Departments to put forward proposals for variations to CAs and capital grants in baselines;
	June	vi)	Departmental letters submitted;
	July	vii)	RTIA by department for 1990-91 fixed;
Bilaterals	September/ October	viii)	bilateral negotiations on CAs and capital grants for all three years;
		ix)	ACGs for 1990-91 formed by adding CAs to RTIA for each service block.

Each step is considered below.

Setting baselines (i)-(iv)

24. Following discussions at official level, we are sufficiently close to agreement for you to put forward proposals for setting baselines for CAs and capital grants for 1990-91 and the two forward years and an RTIA figure for 1990-91 only (items (i) and (ii) above). This is covered in Section C of this submission. The baselines will be finalised in April (iii) and (iv).

Bidding Process (v)-(vi)

25. Once the final baselines are established in April, Departments will begin preparing their bids. Given their interest mainly in ACGs and in total likely spending on their service, they are likely to seek supporting information going beyond the items scored directly in NPT, to inform the bidding process.

26. Discussions at official level have convinced us that a forecast of gross LA capital expenditure must continue to play a part not just in informing bids but also facilitating resolution at the bilaterals and smoothing the presentation of the outcome. In content, the figure would be the same as gross provision for LA capital; in status, it would be quite different - a forecast and not a plan.

27. It is proposed that the figures for gross provision for 1990-91 will be updated to form a forecast of gross LA capital expenditure and be made available before the bidding process. Departments earlier expressed concern that they should be aware of what a particular level of CAs implied for ACGs throughout the Survey. These proposals now go further: Departments would also have a broad view of likely total gross spending. They would know whether baselines CAs and capital grants would be consistent with higher or lower capital expenditure than the gross provision in

the 1989 PEWP. In essence, this allows Treasury and Departments to negotiate on the resources which Government does control with an up to date picture in mind on what is happening to LA capital spending they do not control ie that financed from LAs own resources.

28. These revised forecasts on likely spending on gross LA capital will have to be circulated no later than end-April in order to influence the bidding process. (It should be emphasised that it would not change the baseline CAs figure.) It is an unfortunate accident of timing that further information on spending from receipts will become available first in late June and then again just as the bilaterals begin. It would not in practice be possible to ignore this information; and clearly such changes in economic circumstances would be relevant to the bilateral negotiations. So it is proposed that DOE and Treasury officials should meet before the bilaterals and provide for Departments a final revised assumption about the total use of spending power from receipts and rccos and hence forecast LA capital spending for each of the three Survey years to assist the bilateral negotiations.

29. On the basis of the baseline figures circulated earlier, and informed by the latest data on forecast gross LA capital expenditure, Departments will be invited to put forward proposals for variations from the baseline in late May.

<u>Fixing the RTIA (vii)</u>

30. It is highly desirable that the receipts taken into account (RTIA) by service should be fixed in advance of the bilaterals. Ideally this would be done before the bidding letters were invited: but because of constraints on data availability, it is not possible to settle the figure until mid-July. (RTIAs refer to

accumulated receipts as at end of the previous financial year ie 1988-89 for this year's Survey: the figure is thus not affected by revised forecasts of in-year receipts declared in the Survey.) Once the RTIA is fixed for each service block, any changes to the baseline CAs agreed in the bilaterals add £1 for £1 to ACGs. This should help ensure an orderly Survey.

Bilaterals (viii)-(ix)

31. At the bilaterals, Departments will negotiate on credit approvals for 1990-91 (and by extension ACGs), credit approvals for the two later years and capital grants for all three years. The negotiations will be informed by the latest information on likely spending below the line as already noted. One issue which will concern departments is whether there should also be decisions on ACGs for years two and three. This is covered in Section D.

Presentation of the Survey outcome

32. From the Survey will emerge:

i) provision by service block for capital grants) for 3
) forward
ii) provision by service for credit approvals) years

33. In addition, the following information will then be derived:

a) by linking together CAs and the previously agreed RTIA, it will be possible to establish ACGs for each block for 1990-91;

b) by linking together the latest forecasts of receipts and use of rccos, and the decision on local authority capital items above the line, a forecast of total LA capital expenditure will emerge; (this could be adjusted to reflect the emergence of later information right up to the publication of the Autumn Statement);

c) this forecast of total LA capital expenditure could be broken down by service on stylized assumptions to give an indication of forecast spending by service for 1990-91 (it would not be sensible to project spending by service on this basis for years 2 and 3). Thus Departments would be able to say at the conclusion of the Survey that, if local authorities spent their receipts in the same pattern by service as in the latest year for which outturn information is available, the provision of CAs and grants would be consistent with a forecast expenditure on the service of £X million.

34. In the Autumn Statement itself, total provision for credit approvals and capital grants will be shown in the tables; the forecast for total LA capital expenditure will be identified separately. Departmental CAs and capital grants will be components of the Departmental tables showing total programme expenditure but will not be separately identified except possibly in the text.

35. Departments may wish to show ACGs and capital grants in their Departmental Press Notices and may choose - on the stylized assumptions agreed - to publish the forecast of total capital expenditure for the year ahead as well as the CAs.

36. In the White Paper to be published in January, Departmental tables will show credit approvals and capital grants; ACGs and perhaps the stylized forecast of gross capital expenditure would be referred to in the text (if at all).

SECTION C: SETTING THE BASELINES

Total Credit Approvals

37. An official group has been meeting for several weeks to discuss setting the provisional baseline for CAs and capital grants for 1990-91. The basic method is relatively straightforward: starting with gross provision for 1990-91 as determined in last year's Survey, what room is left for credit approvals after other likely spending from other sources of finance has been subtracted?

38. Table 1 shows the basic steps in the calculation. Most of the lines in the table are uncontroversial: but there has been considerable difficulty in reaching agreement on lines 3 and 4 - the likely spending from available capital receipts. That is estimated from total forecast available receipts (not a disputed figure) multiplied by an assumption about the likely extent (in terms of a percentage figure) to which they will be used. It is this assumption which has proved difficult to agree.

39. For the last four years under the present capital control regime, the percentage of available spending power from receipts likely to be spent has been set at around 50%. For 1989-90, it was assumed to be 53% when gross provision was set - but may well turn out to be rather higher at 60% or above. In 1990-91, with the introduction of the new financial regime the stock of capital receipts which can be spent will fall by around one-third from an estimated £4.6b to £3.2b. The flow of new capital receipts which can be spent will be reduced to one-quarter (housing) and one-half (non-housing) of the previous rate - for any given level of receipts.

40. Against this background, DOE officials proposed that the assumption for 1990-91 should be that only 40% of receipts available for spending would be spent. They pointed out that the introduction of new capital regimes had in the past sharply cut back spending. Treasury officials initially argued for 50% -

taking the line that the level of spending would fall in proportion to the reduction in the stock. But this took no account of the uncertainty effect or reduced inflows and we now favour an assumption of 45%. All other departmental officials would reluctantly accept 45% but DOE officials (who had at one point accepted an assumption equivalent to 43%) reserved their Ministers' position.

41. On an assumption that LAs will choose to spend only 45% of the capital receipts available, the room for credit approval should be £2,353m. This may seem high relative to the figure of £1918m for baseline capital allocations for 1989-90. But the figures are not directly comparable because of the changes in the capital control regime (see table 2): both are however consistent with the relevant gross provision. What is clear and worrying is that in 1990-91 and for the next few years thereafter, there will be considerable uncertainty about LA capital spending financed from their capital receipts. There must be a risk of an overshoot (or undershoot) of GGE targets because of this.

Distribution of CAs by service

42. Officials have reached agreement that the best way of distributing the baseline CAs is to undertake the calculation described in table 1 for each service block separately, starting with the gross provision by block agreed in the last Survey. The provisional baselines for CAs for each service which emerge are set out in table 3.

RTIA

43. The relevant receipts to be taken into account are the accumulated receipts as at March 1988 - the latest certified figure for receipts available. The main issue on RTIAs is the percentage of these to be taken into account. Two policy objectives need to be balanced. The higher the percentage, the less the incentive on LAs to realise asset sales. (This is because the higher the level of receipts taken into account for an individual authority the less will be its share of the available

CAs.) On the other hand, a high percentage of receipts taken into account means that there will be a greater ability to match credit approvals to real and financial needs. The particular advantage to the Treasury is that we can argue for a smaller total amount of CAs to meet any given level of real needs.

44. On balance, Departments at official level are prepared to support a figure of 25%, giving a total RTIA of £475m. Because only around 45% of receipts are likely to be spent, this means that very nearly half of the likely spending from accumulated receipts as at March 1988 will be taken into account through the RTIA in distributing CAs.

Distribution of RTIAs

45. This sum has to be distributed amongst the service blocks. The conclusion at official level was that, since these receipts are effectively a mechanism for directing ACGs towards a particular service block their distribution should reflect the relative service priorities held by central government. For 1990-91, the best available indicator of that is the gross provision. It is therefore proposed that the RTIAs be distributed in proportion to gross provision. (This is a rationalisation of the outcome of lengthy horse-trading which is satisfactory to us and most Departments.)

46. The outcome in terms of CAs, RTIAs and hence ACGs is shown at table 3.

Forward years

47. Finally, it is proposed that baseline CAs and capital grants for 1991-92 and - in due course - 1992-93 should be formed by applying an uplift factor to the baselines for 1990-91. The alternative of trying to set CAs consistent with 1991-92 gross provision would be technically possible but difficult and open to prolonged dispute. (Our calculations also indicate it is likely to be less favourable from a Treasury viewpoint.)

48. It is proposed to apply a 2½% uplift factor to form the 1991 92 baselines, (as proposed for grants on the current side) -see table 4. DOE will be looking for a higher figure to reflect their expectation of falling spending from capital receipts. But Mr Ridley may be reluctant to press the point at this stage, instead leaving the argument for the bilaterals.

49. It will be necessary to construct a baseline for year 3 (1992-93). The usual procedure is that a common uplift factor is applied to all items in the planning total. It is proposed that the baseline for CAs and capital grants in 1992-93 would be treated in the same way. On the normal timetable, Treasury would circulate the amended baseline by end-May.

SECTION D: HANDLING

50. Colleagues have already accepted credit approvals as the currency for the Survey and agreed to the outline timetable in your letter of 13 January. At official level, the proposals on the provisional baseline for 1990-91 discussed in the preceding section, have already obtained near-agreement - with only DOE officials reserving their Minister's position. You are also in a position to put forward proposals for the 1991-92 baseline.

51. I recommended that you now write to Mr Ridley setting out these proposals and seeking formal agreement to the provisional baselines. It would also be appropriate to describe the role now envisaged for the RTIA and the forecast of total capital expenditure in the letter - again Departmental officials are likely to welcome these.

ACGs for Future Years

52. But there is one important issue still unresolved. As described earlier, the Survey will settle provision for 1991-92 and 1992-93 in terms of credit approvals and capital grants. But as noted in paragraph 14, both Departments and individual LAs will be expecting ACGs to be determined and announced for the two forward years. The Treasury view is that it would not be safe to give such commitments in terms of ACGs.

53. We have considered carefully what information might be given to local authorities about the room for capital spending in future years. In the consultation paper, it was proposed that notice of ACGs for years 2 and 3 equal to 85% of the provision for year 2 and 70% of the provision for year 3 should be given to individual authorities. That presents serious problems.

54. Ministers will be deciding only on CAs by service for years 2 and 3 in the Survey, not ACGs. It would only be possible to project ACGs if an assumption were also to be made about RTIAs. That in turn would require assumptions to be made about available

receipts, even though spending from receipts is unclear; and, under the philosophy of the new capital finance regime, such expenditure is for LAs not central government to determine. Moreover were that projection inaccurate because LAs ran out of capital receipts more rapidly, the ACG figure could only be maintained with unchanged CAs by increasing the RTIA percentage. That would be perverse (as receipts were running out, the Government would be reducing the incentive to realise receipts). In short, if the Treasury were committed to an ACG figure for say 1991-92 and the RTIA figure fell, we would have effectively conceded more CAs in the baseline than agreed by Ministers in the previous Survey. That is clearly unacceptable.

55. Nor does a forward indication in terms of ACGs work satisfactorily at the level of an individual LA. Imagine a commitment to a £5m ACG for 1991-92, based on £4m in CAs and an RTIA of £1m. In 1990-91, the LA could spend <u>all</u> available receipts (ie including the £1m RTIA): the Government would be forced to give it even more spending power, with £5m rather than £4m in CAs for 1991-92. This would be a very perverse incentive.

56. Nor is a figure for ACGs meaningful to an individual authority given an ability for the Government to change the RTIA percentage. The Treasury believe it would be more helpful to an individual LA if the undertaking were framed in terms of its block CAs ie that the block CAs would not be less than X% of the previous year's figures. This would give LAs a real indication of the resources available to them. The percentage numbers will need to be agreed: but they are likely to be lower than the 85% and 70% percentages previously in mind for ACGs. To safeguard the proposal from abuse, a let-out clause will be necessary so that in the event of a major receipt from a large sale (eg the entire council house stock) the CA figure for an individual LA could be cut further ie the commitment would be framed in terms of X% of CAs, provided receipts did not grow by Y%. (Y will have to be reasonably generous to avoid any disincentive to asset sales.)

57. The logic of this is that Ministers will therefore not need to decide ACGs or RTIAs for the two forward years. That is necessary to reduce the exposure of the Treasury. But several Departments will be very unhappy at the prospect - particularly those which regard ACGs as the indicator of needs. Moreover the wording of the consultation document is (with hindsight) regrettably unequivocal in the technical section in terms of the commitment to a future indicator of ACGs: fortunately, the commitment in the main document is framed in terms of credit approvals (see attachment A).

X

58. Several Departments are likely to regard any 'backsliding' on this commitment to ACGs as an explosive issue likely to antagonise the local authority associations - even though, for the reasons explained above, it may be possible to put in its place a more meaningful commitment to CAs for the individual LA. That said however LG and GE consider it tactically better to get agreement on the rest of the Survey proposals and baselines first - though you will need to flag up future commitments as an issue for further consideration.

59. But the tactics are a matter for your judgement. I attach a draft letter for you to send to Mr Ridley.

BHP

BARRY H POTTER

bas1
2/2/89

TABLE 1

TRANSITIONAL SURVEY - TOTAL CAs and RTIAS

CALCULATION OF TOTAL CAs.

	£ million 1990-91
1. Gross provision	5207
2. add receipts netted off in PES (1)	150
3. less forecast use of accumulated receipts	1225
4. less forecast use of in-year receipts	655
5. less forecast revenue contributions	400
6. less capital grants	725
7. ROOM FOR TOTAL CAs	2353

NOTES:
(1) Repayments of some grants and advances other than mortgages and leasing. These are treated as receipts in the capital control system but not in PES.

TABLE 2: COMPARISON OF BASELINE CALCULATIONS FOR 1989-90 AND 1990-91

A. CALCULATION OF BASELINE CAs: 1990-91

	£ million 1990-91
1. Gross provision	5207
2. add receipts netted off in PES (1)	150
3. less forecast use of accumulated receipts	1225
4. less forecast use of in-year receipts	655
5. less forecast revenue contributions	400
6. less capital grants	725
7. ROOM FOR TOTAL CAs	2353

NOTES:
(1) Repayments of some grants and advances other than mortgages and leasing. These are treated as receipts in the capital control system but not in PES.

B: CALCULATION OF BASELINE CAPITAL ALLOCATIONS: 1989-90

		£ million 1989-90
+	1 Gross spending (pes)	4975
-	2 non-prescribed spending	850
-	3 receipts netted off pes	-175
=	4 PRESCRIBED SPENDING	4300
	5 Spending power from:	
	accumulated receipts	3465
	in-year receipts	778
	trading profits	60
	tolerance	192
	+ Total	4495
	/6 spending power usage	53.0%
-	=7 implied spending power	2382
=	8 ROOM FOR ALLOCATIONS	1918

MEMO ITEM:	
Accumulated Receipts	12600
Prescribed Proportion	27.5%
In-Year Receipts	2902
Prescribed Proportion	26.8%

tsm4
1/2/89

TABLE 3: PROPOSED SERVICE BLOCK BASELINE

	Hous.	Trans.	Educ.	PSS	Other	TOTAL
1. CAs	1257	562	320	65	149	2353
2. RTIAs	270	78	49	11	67	475
3. ACGs (1+2)	1527	640	369	76	216	2828

TABLE 4: PROPOSED BASELINE CAs AND CAPITAL GRANTS FOR 1991-92
(uplifted by 2.5%)

	Hous.	Trans.	Educ.	PSS	Other	TOTAL
Credit Approvals	1288	576	328	67	153	2412
Capital grants	461	205	26	5	46	743

ANNEX A

"CAPITAL EXPENDITURE AND FINANCE": A CONSULTATION PAPER (7 JULY 1988)

21. The Government will place limits - called credit approvals - on the level of commitments which individual local authorities may enter into in any year and finance by borrowing or credit arrangements. Before the beginning of each financial year, each authority will be told the amount of their basic credit approval for that year. That amount will have been calculated in light of the Government's assessment of the appropriate shares for the authority of the provisions in public expenditure plans for the services administered by the authority. <u>To assist forward planning, each authority will at the same time be given an indication of levels below which their basic credit approvals for the next two financial years will not be reduced.</u> Basic credit approvals may be enhanced by supplementary credit approvals covering particular projects or programmes.

A.17 When issuing to an authority its BCA for any given financial year, the Secretary of State would specify a provisional total for the authority's ACGs for each of the next two following financial years. He would also indicate what allowance he intended to make for receipts in those years. When he came to issue the final BCA for those years, he would not base them on lower ACGs than he had specified, nor allow for receipts to a greater extent than he had indicated. The Government's present intention is that the total of the provisional ACGs thus specified would be about 85% and 70% of the amount consistent with the relevant public expenditure provisions for BCAs for the two following financial years.

DRAFT LETTER TO SECRETARY OF STATE FOR ENVIRONMENT

LOCAL AUTHORITY CAPITAL (ENGLAND): SETTING PROVISIONAL BASELINES FOR 1989 SURVEY

I am grateful to colleagues for their agreement that we should adopt credit approvals as the main currency for our bilaterals discussions on local authority (LA) capital in the 1989 Survey. I confirm that we shall look at this again at the end of this year.

The next step is to set the baselines for credit approvals and capital grants for the Survey period, and agree a provisional assumption about the level of receipts to be taken into account (RTIA), in order to set Annual Capital Guidelines (ACGs) for 1990-91 at the end of the Survey. It is necessary to reach a firm agreement now on the method of setting the baseline so that the Survey guidelines can be issued within the next week or so. I attach some figures showing what my proposals imply for the baseline. I accept that we should review these figures rather than the method, early in April in the light of any further information about receipts. (Of course the baseline itself is only a starting point for our Survey discussions.)

Our officials, together with those from the other relevant Departments, have considered the baselines for both capital grants and credit approvals in 1990-91. For capital grants, the figures have been estimated directly from the information provided by Departments. For credit approvals, the figures have been calculated by subtracting from the gross provision for each service block, the likely spending from sources other than credit approvals, that is capital grants, revenue contributions (RCCOs) and use of capital receipts. The method is agreed amongst officials. But there is genuine difficulty in projecting one element within the calculation - the likely rate of spending out of capital receipts.

At present, the assumed rate of spending from available capital receipts for 1989-90 is 53%. In practice, this figure may well exceed 60% next year. For 1990-91, my officials were inclined to the view that it would be appropriate to assume a broadly similar rate of spending: because of the reduced stock of receipts available for spending in 1990-91, the assumed level of spending from capital receipts would have come down by nearly one-third. However, your officials are convinced that not only the level but also the rate of spending from capital receipts will fall more substantially in 1990-91 - as LAs respond cautiously to the new regime. My understanding is that weighing all the considerations my officials and those in other departments were prepared to accept an assumed rate of spending of available capital receipts of 45%: your officials have reserved your position.

Having discussed this with my officials, I would reluctantly be prepared to accept the 45% figure. But I should record my concern that many LAs, having become used to high spending from their capital receipts, and, therefore being committed to a large capital programme, may well sustain a rather higher rate of spending from their receipts in the first year of the new system. I would therefore not be willing to accept a lower spending assumption. On the basis of the assumption that LAs will choose to spend 45% of the amount available from capital receipts, I propose that we adopt as the baseline a total credit approvals figure of £2353 million, distributed as set out in Table A.

Officials have agreed that the RTIA percentage should be set at 25% for 1990-91, giving a total RTIA of £475 million. Adding this to the total CAs would provide for ACGs at £2828 million.

Officials have also considered how the total RTIAs should be distributed amongst service blocks. The RTIAs (when added to the CAs) will form the ACGs and it is the ACGs which are distributed by Ministers. Accordingly I propose that they should be distributed according to gross provision in the PEWP for 1990-91, as an indicator of our relative service priorities. The figures are displayed in Table A.

It is also necessary to set provisional baselines for years 2 and 3. I suggest that this should be done by applying an uplift factor to the baseline for 1990-91 for capital grants and credit approvals and that a factor of 2½% be adopted ie the same as proposed to grants in LA current for 1991-92 - as shown in table B. For 1992-93, I will be bringing proposals forward at a later stage in line with the usual timetable for setting baselines for the third year.

To help clarify the arrangements for this year's Survey, I attach at Annex A a revised timetable. Our officials have also discussed two aspects of this timetable and Survey arrangements to which I should like to draw attention.

(i) RTIAs: I propose that we review the provisional RTIA figure for 1990-91 in July in the light of the returns on accumulated receipts available for 1988-89. The level of RTIA would be revised to take account of this information, while retaining the 25% assumption and the proposed pattern of distribution. The RTIA would then be fixed by service so that in the bilateral negotiations each £1 change to CAs would equal a £1 change to ACGs for 1990-91.

(ii) Gross LA capital expenditure: I propose that our officials should circulate information on projected total capital spending as it becomes available to inform both the bidding process and the bilaterals. For the year ahead, Departments may wish to publish an indication of their share of the forecast total local authority capital expenditure underlying the GGE forecast using stylised assumptions based on the most recent pattern of outturn spending.

Finally I am conscious that further consideration needs to be given to what is announced about provision for the forward years. Specifically we need to agree what indications should be given about the future provision for services and for individual LAs, and in what terms any indications should be expressed, bearing in mind the proposals set out in paragraph 21 of the consultation paper that each LA should be given an indication of its minimum basic credit approvals for the two forward years. I am asking my officials in consultation with the other departments involved to consider and make recommendations on this as soon as possible.

I am copying this to the other members of E(LA) and to Sir Robin Butler.

tsm4
1/2/89

TABLE A: PROPOSED SERVICE BLOCK BASELINE

	Hous.	Trans.	Educ.	PSS	Other	TOTAL
1.CAs	1257	562	320	65	149	2353
2.RTIAs	270	78	49	11	67	475
3.ACGs (1+2)	1527	640	369	76	216	2828

TABLE B: PROPOSED BASELINE CAs AND CAPITAL GRANTS FOR 1991-92
(uplifted by 2.5%)

	Hous.	Trans.	Educ.	PSS	Other	TOTAL
Credit Approvals	1288	576	328	67	153	2412
Capital grants	461	205	26	5	46	743

lg1.va/potter/minutes/annex.cap

ANNEX A

TIMETABLE FOR LA CAPITAL

	<u>February</u>	i)	set baselines for credit approvals and capital grants 1990-91 and 1991-92 on provisional assumption about receipts;
		ii)	set a provisional assumption about RTIA for 1990-91;
Baselines	<u>April</u>	iii)	finalise baselines in the light of latest data on receipts;
		iv)	create baseline for 1992-93;
	<u>May</u>	v)	invitation to Departments to put forward proposals for variations to CAs and capital grants in baselines;
Bidding	<u>June</u>	vi)	Departmental letters submitted;
	<u>July</u>	vii)	RTIA by department for 1990-91 fixed;
	<u>September/</u> <u>October</u>	viii)	bilateral negotiations on CAs and capital grants for all three years;
Bilaterals		ix)	ACGs for 1990-91 formed by adding CAs to RTIA for each service block.

FROM: A C S ALLAN
DATE: 10 FEBRUARY 1989

PS/CHIEF SECRETARY

cc Sir P Middleton
Mr Anson
Mr Monck
Mr Phillips
Mrs Case
Mr Edwards
Mrs Lomax
Miss Peirson
Mr MacAuslan
Mrs Butler
Mr A White
Mr Wood
Mr Laite

LOCAL AUTHORITY CAPITAL EXPENDITURE: 1989 SURVEY

The Chancellor has seen Mr Potter's minute of 2 February. He thought it was, as Mr Potter says in his paragraph 57, regrettable that the wording of the consultation document was unequivocal in the technical section in terms of the commitment to a future indicator of ACGs.

ACSA

A C S ALLAN

lg.jb/hudson/minutes/dr.sub

RESTRICTED

I trust the CST does not believe X. I am far too old & cynical to believe it myself. And in any event I consider it will be thrown away [illegible] the Tsy's argument. ~~That [illegible]~~ for a larger RSG: viz the need to [illegible] spending [illegible]

FROM: A P HUDSON
DATE: 28 FEBRUARY 1989

1. MR EDWARDS Agreed with me

AJCE 28 ii

2. CHIEF SECRETARY

cc Chancellor
Sir P Middleton
Mr Anson
Mr Phillips
Mr Monck
Mrs Case
Mrs Lomax
Miss Peirson
Mr MacAuslan
Mr Potter
Mr Mortimer
Mr G C White
Mr Brook
Mrs Chaplin
Mr Call

Ch

I don't feel very strongly about the choice between the two options discussed in this note. My instincts are to stick with the usual system & refuse to reopen AEF, but that's probably just because that's how I worked!

TREATMENT OF LOCAL AUTHORITY CURRENT EXPENDITURE IN THE 1989 SURVEY

We now have all the responses to your 31 January letter to colleagues proposing arrangements for the handling of local authority current expenditure in the 1989 Survey.

The Main thrust of the responses

2. Ministers have agreed to most of the key proposals:

- a July announcement of an envelope of "Aggregate Exchequer Finance" (AEF) covering the NNDR, revenue support grant, and certain specific grants, <u>without</u> breaking this envelope down into its components;

- the July announcement to include the aggregate need to spend, and the community charge for spending at need (CCSN);

- Survey baselines for specific grants, and for RSG plus NNDR taken together, to be derived by uprating the corresponding 1989-90 figures by 2½ per cent for each of years 1 and 2, with the same uplift for year 3 as elsewhere in the Survey. It is pleasing - and somewhat surprising - that colleagues did not object to this approach. Although it is a concession from our original proposals, it nonetheless forces them to bid uphill.

3. You suggested that these issues should be discussed in E(LA). I understand, however, that the Prime Minister has decided they should be discussed in E(LF) under her chairmanship.

4. Most of the points made in the responses to your letter are really markers for the Survey discussions, and for next year's arrangements.

- There is general agreement that the arrangements should be reviewed before the 1990 Survey, with some strong support for a move to an October announcement in future (Messrs Clarke, Baker, Channon, and Hurd).

- Messrs Baker, Channon, and Hurd stress the importance of a realistic figure for the needs assessment, taking account of service needs separately. This is consistent with their enthusiasm for a "bottom up" approach to determining aggregate needs, against which we will need to set considerations of affordability and overall public expenditure constraints - you registered this point in your 14 February letter to Mr Ridley about the arrangements for consultation with local authority associations.

- Mr Hurd accepts your baseline proposals for specific grants as a benchmark. But he points out that they do not even match the increases agreed in last year's Survey. He says he would not wish to see his bids judged "against a benchmark which is clearly unrealistic". HE advise that there will be a bid for around an extra £100 million to cover the Edmund Davies pay formula, which will be virtually irresistible.

We do not think it is worth picking up any of these points at this stage. We shall take them into account in considering the strategy for the Survey, which you may want to discuss with us in the Spring.

The nature of the July Envelope

5. The serious issue emerging from the responses is how far colleagues are prepared to regard the July envelope as fixed.

6. Mr Baker suggests in his letter that the AEF envelope should be regarded as flexible after it has been announced in July. Mr Ridley and Mr Walker both say that they will expect to be consulted if decisions on specific grants in the autumn have implications for the level of RSG.

7. Their concern is this. In July, a decision will be reached on the total of AEF, based on assumptions, which will not be announced, about the likely breakdown between specific grants, NNDR, and RSG. Mr Ridley will want to secure agreement not merely on an adequate level of AEF, but, within that, on a reasonable level of RSG - this is the grant which is specifically his responsibility. Within a fixed AEF envelope, however, any increase in specific grants agreed in the Autumn will be offset in full by lower RSG. Mr Ridley's concern is that, to take the most likely example, a significant increase in the police grant might leave him with a level of RSG which he would regard as unacceptable. That is why he asks to be consulted. Mr Walker is in the same position.

8. Behind Mr Ridley's request to be consulted is the danger that he would ask for an increase in the AEF envelope which had been agreed and announced in July, so that the increases in specific grants did not result in lower RSG.

9. Re-opening the AEF decision would be an extremely bad outcome from the Treasury's point of view.

- One of the arguments for settling AEF early is that it gets that aspect of the Survey out of the way.

- When we discussed this last month, you thought that a generous local authority settlement was probably unavoidable and proposed to use this as a constraint on the rest of the Survey. The last thing we want is to have a generous settlement reopened.

- The final announcement of AEF will come in late October, shortly before the Autumn Statement. It would be an extremely bad start - not least for market management - if the Government had to announce that it had failed to stay within a total set only three months previously.

- Arguably, it would also be bad politics. The local authorities are bound to say that the July settlement is inadequate, and there will be some dire predictions about the level of community charges. Extra finance in October would look as though the Government was trying to buy off these consequences.

10. To put this in perspective, the amounts involved should not be very large. The papers for the July E(LF) discussions would have to include realistic forecasts of the level of specific grants. The risk for Mr Ridley would thus be the difference between the total of specific grants that emerged from the bilaterals, and the figure assumed in July. It should be possible to estimate the large police grant to within a maximum of £30 million, and probably less. So even if there were increases in some of the smaller grants, the amount at stake would not be very great, in the context of an AEF envelope of perhaps £23 billion.

11. We understand, however, that Mr Ridley would try to reopen AEF for sums of this size, and that Mr Walker would do the same for as little as £5 million. They would argue that the increase in specific grants meant that the Government itself was putting upward pressure on the Community Charge, which would be compounded by reducing RSG. It would be difficult to deny this: experience suggests that higher specific grants lead mainly to higher spending, whereas an increase in RSG is mainly reflected in lower rates. We shall be using precisely this argument ourselves to resist bids for higher specific grants.

Hmm X

12. Mr Ridley would also argue that higher specific grants should mean an increase in the aggregate need to spend, and hence in the Community Charge for spending at need (CCSN), both of which would be published in July. We would try to resist this on the grounds that the aggregate need to spend was a measure of affordable spending. But the terminology is against us: we might not get much support for the argument that, because spending on the police had increased, other spending which had been 'needed' in July was no longer 'needed'.

13. The question is whether you could hold the line on refusing to reopen AEF. Although the sums involved are relatively small, Mr Ridley would try to run the argument that they could therefore be readily conceded, to avoid any upward pressure on community charges at all. None or the other members of E(LF) would have any reason to side with the Treasury, and the Prime Minister will no doubt be very concerned about the implications for the community charge. So there must be some risk of not being able to hold the line.

A possible alternative approach: decide specific grants in July

14. To reduce the risk of AEF being reopened you might like to consider handling the discussions in a slightly different way. Instead of the original approach of making a forecast of specific grants in July, with discussion to follow in the Survey bilaterals, we could aim to reach agreed <u>decisions</u> on these grants in July, as far as we possibly could. In practical terms, it should be perfectly possible to settle most, if not all of them.

15. Compared to the original intention, this approach has both pros and cons, from the Treasury's point of view.

16. The <u>pros</u> are:

(a) it would minimise the chance of AEF being reopened;

(b) it avoids the awkwardness of having to make a realisitic forecast of specific grants in July, which might become a floor for negotiations in bilaterals;

(c) it provides an opportunity, which has never existed before, for collective discussion of the settlement of specific grants. Within any given total for AEF, higher specific grants would lead to higher local authority spending, higher community charges, and higher GGE. You might be able to agree with Mr Ridley the broad outcome for AEF and RSG, and make common cause to beat down bids for higher specific grants.

17. The cons are:

(a) you might have a better chance of making spending Ministers think more critically about specific grants if they were discussed in the autumn bilaterals;

(b) in the case of the police specific grant, HE division would have more time to exploit the results of the current inter-departmental study on police output and performance indicators in discussions on forecast police manpower needs;

(c) there is a risk that E(LF) might be in favour of high bids on both specific grants and RSG, with a very high figure for AEF as a result;

(d) there would be a certain amount of extra work for you in June and July, though only the Home Office grants might require an extra meeting.

Assessment and Next Steps

18. We think the choice between these two approaches is finely balanced. The approach we originally envisaged gives us more options on specific grants, but carries the risk of AEF being re-opened. The alternative reduces this possibility, but carries some risk that higher bids on both fronts will be accepted. The issue comes down to which approach gives you the best negotiating position, and whether you think AEF could be made to stick if specific grants were increased in the bilaterals.

19. In terms of writing to colleagues, we think the first thing to register is that AEF must remain fixed. We think it is then, on balance, worth putting forward the alternative way of handling specific grants, and I attach a draft letter on that basis. If you prefer to stand pat on the original approach, I shall let you have a revised letter. In either case, it would be very helpful if you could write within the next day or so, so that the approach can be agreed before the Survey guidelines are circulated on 15 March.

AH

A P HUDSON

lg.jb/hudson/minutes/dr.cst

DRAFT LETTER FROM CHIEF SECRETARY

The Rt Hon Nicholas Ridley AMICE MP
Secretary of State for the Environment
2 Marsham Street
LONDON
SW1P 3EB

March 1989

TREATMENT OF LOCAL AUTHORITY CURRENT EXPENDITURE IN 1989 SURVEY

Thank you for your 7 February letter in response to mine of 31 January, which proposed arrangements for the handling of local authority current expenditure in the 1989 Survey. I am also grateful to other colleagues for their comments.

I am grateful to you and colleagues for your general agreement to my proposals. I note the points made about baselines and the importance of the decision on the aggregate need to spend. These are things we shall clearly want to consider very carefully during the Survey.

The most significant point which has arisen in the correspondence ~~in~~ is Kenneth Baker's suggestion that there may be a need to change the funding envelope in October from the figure announced in July. I have to say that I cannot agree with this. If we are to announce the envelope in July, we must stick to it. Setting one envelope in July and then another three months later is no way to conduct business, and would be thoroughly out of character. It would mean a very bad start to the main public expenditure announcements.

If you and colleagues are concerned that decisions in October on specific grants could exceed expectations and thus lead to changes in RSG within the fixed envelope, I suggest we should aim to decide specific grants, as far as possible, in July. So far as I am aware, there is nothing to prevent this, except possibly in the case of police grant; but even there, the outcome should be clear to within £20-30 million. This is a tiny amount in the context of a funding envelope which is likely to be over £20 billion, and thus would remove any question of reopening the July decision.

I am copying this to the Prime Minister, to members of E(LF) and E(LA), and to Sir Robin Butler.

JOHN MAJOR

chex.rm/aa1/51 **RESTRICTED**

FROM: A C S ALLAN
DATE: 1 March 1989

PY

PS/CHIEF SECRETARY

cc Sir P Middleton
Mr Anson
Mr Phillips
Mr Monck
Mrs Case
Mr A J C Edwards
Mrs Lomax
Miss Peirson
Mr MacAuslan
Mr Potter
Mr Mortimer
Mr Hudson
Mr G C White
Mr Brook
Mrs Chaplin
Mr Call

TREATMENT OF LOCAL AUTHORITY CURRENT EXPENDITURE IN THE 1989 SURVEY

The Chancellor has seen Mr Hudson's minute to you of 28 February. He trusts the Chief Secretary does not believe the argument that "an increase in RSG is mainly reflected in lower rates". The Chancellor's experiences over many years make him too cynical to believe it himself. And in any event to concede it would be to throw away one of the Treasury's main arguments for a tough RSG: viz the need to control spending.

ACSA

A C S ALLAN

CONFIDENTIAL

1. ~~MR PHILLIPS~~

2. CHIEF SECRETARY

Ch
Longwinded but sensible. CST needs to be v tough. (No need to read Annexes)
AA

FROM: B H POTTER (LG1)
x4790
Date: 27 April 1989

Copies attached for:

Chancellor
Paymaster General

cc: Sir Peter Middleton
Mr Anson
Mr Monck
Mrs Case
Mrs Lomax
Mr Edwards
Miss Peirson
Mr MacAuslan (GE)
Mr Hudson (LG)
Mr G White (LG)
Mr Rutnam (LG)
Mr Call
Mrs Chaplin

I have discussed this in draft with LG & GE.
You are already well aware of the special difficulties for this 1st year for the C.C and NPT. I should underline that the expenditure numbers in these pps are very tentative.
HP 2/4

[illegible] 2. CST [illegible] Mr [illegible]

LOCAL AUTHORITY CURRENT: TREASURY STRATEGY FOR E(LF)

This note and attached papers recommend a strategy for Treasury Ministers to pursue in the E(LF) negotiations on the 1990-91 local authority (LA) current settlement in England+. The papers are the work of Messrs Hudson, White and Rutnam in LG1. The note and papers have been discussed with Mr Phillips, Mr Edwards and GE.

2. This year's negotiations will be the first under the new community charge regime and the new planning total. The structure of the negotiations was set out in your letter of 31 January and the timetable is summarised at Annex A. This note is concerned with the main steps between now and end-July. In that interval E(LF) must determine and announce for England for 1990-91:

- Aggregate Exchequer Finance (AEF);
- the assessed need to spend; and
- the community charge for spending at need (CCSN).

POTTER → CST 27/4

+The arrangements for Scotland and Wales will be dealt with separately.

CONFIDENTIAL

(A diagram showing the relationship between these variables, their component parts and actual community charges and actual LA current spending is at Annex B.)

3. It is AEF which scores directly in the new planning total; both assessed need to spend and the CCSN are in the nature of supporting information to the E(LF) decision on AEF.

Objective

to DoE not necessarily to Tsy

4. Clearly the potential/actual or "doorstep" community charges will be of greatest concern. But much attention will also be paid to the CCSN at E(LF) given the need to announce a politically saleable figure in July. There will be enormous pressure for a big increase in grant for local authorities in order to engineer low community charges.

5. However the overall aim of the community charge policy needs to be emphasised: it is to control and restrain local authority spending more effectively than in the past through greater accountability to the electorate - not to provide extra grant that will generate higher LA spending. For 10 years, the Government has been trying to rein back LA spending by cutting the grant percentage and (until this year) discouraging extra spending at the margin. Continuity of that policy is critical now, particularly in the absence of any financial pressures at the margin.

6. In place of such financial pressures is the improved electoral accountability of the new local government financial regime. But in 1990-91 at least that accountability cannot be expected to hold back LA spending; because:

i) local councils will feel able to budget high and blame central government for whatever the consequences are in terms of high Community Charges (CCs);

ii) the operation of the safety net (see separate section) will blur the impact of LAs budgets decisions on the CC;

iii) the transition from a local tax system based on the tax liability flowing from property to one based on individuals liability will (even after the safety net) make it difficult for electors to judge the LA's spending performance;

iv) the only elections in 1990 will be in London (plus a minority of shires and metropolitan districts).

7. Given the need for continuity of policy on LA spending and the very weak pressures on spending at the margin, the Government's and Treasury's traditional objectives on LA current spending must remain in place for the negotiations. Despite the special circumstances, your main aim should be to hold down the quantum of Exchequer support (AEF) towards local authority spending. AEF scores directly in the NPT and is the instrument designed to deliver the Treasury's underlying objectives:

a) bringing downward pressure to bear on local authority spending, all of which scores in GGE (the ultimate target of the Government's public expenditure strategy); and

b) minimising the burden of local government spending on the general taxpayer.

8. This leads to a potentially useful argument in the E(LF) negotiations for Treasury Ministers. For 10 years the degree of Exchequer support for LA spending has been perennially and consistently declining: it would be wrong and indeed contrary to the whole thrust of the new local government finance regime to reverse that policy now. The most that Treasury Ministers might support would be a temporary suspension of the downward pressure ie to maintain, rather than continuing to cut, the grant percentage (newly defined as the ratio of AEF: need to spend) in 1990-91.

Negotiation Framework

9. However the negotiating mechanisms for achieving your aims must change this year. The focus of the negotiations must be shifted to reflect the new local government finance regime.

10. As you will recall, in past years the two key decisions in E(LA) have been on provision for total (relevant) current expenditure and the quantum of Exchequer support (the old Aggregate Exchequer Grant (AEG)). These decisions were taken against a back-drop of forecast levels of total (relevant) current expenditure, actual levels of Aggregate Exchequer Grant and the projected consequences for rates. Though the provision for total current expenditure in the PEWP did not fully reflect the central projection of LA current spending, the decisions were very much based on forecast levels of actual local authority current expenditure and rates.

11. The negotiations under the new regime should focus on Exchequer support as before. But the back-drop of supporting information announced in July will not be on forecast levels of actual spending and local taxes but on the assessed need to spend, and the community charge for spending at need (CCSN). Under the new regime, it is these variables which central government determines: actual spending and actual community charges are for the local authorities to decide. This is of course reflected in the new planning total presentation.

12. A new form of negotiation framework is required. The choice lies between two approaches: the first - A - would assess the CCSN directly; the second - B - would first establish actual CCs and work back to the CCSN.

A			B		
	Need to spend			Actual spending	
AEF	CCSN	CCSN	AEF	"doorstep" CCs	.
	.	.		.	.
	.	.		.	.
	.	.		.	.
	.	.		.	.

13. There are a number of powerful Treasury reasons for adopting approach A:

- it follows from the logic of the new financial regime and the NPT;

- it is the CCSN which can be determined; projections of "doorstep" CCs are subject to a wide margin of error (like DOE's old projections of domestic rate increases);

- it is more likely to deliver Treasury objectives: under approach B, E(LF) will be frightened by the prospect of large CC figures and driven further down the table towards higher AEF figures; taking approach B and working back to acceptable figures for CCSN and need to spend would be to our tactical disadvantage;

- approach B takes the decisions in the wrong logical sequence ie it decides actual spending before need to spend; moreover how much actual spending is to be reflected in the LA self-financed expenditure in the Autumn Statement is a decision for the Treasury (in consultation with DOE) not E(LF) to take.

14. However, it is by no means clear that other Ministers including the Prime Minister, will be easily convinced that an approach along the lines of A above is best (although DOE will probably support it). Most members of E(LF) will have a very natural inclination to favour negotiations around actual forecast spending and actual community charges, not the CCSN. In particular, there will be a strong desire to inject more grant into local authorities in order to hold down actual community charges. For the reasons set out above, that would be to our tactical disadvantage. But the case for approach A is best set out in any discussion (including the opening meeting with the Prime Minister referred to in paragraph 41) as follows:

- the Government is responsible for the CCSN, not for individual CCs - they are up to the individual authority; that is part of the political attraction of the new regime;

- some authorities will set high CCs for political reasons, whatever the Government does; giving more grant to such authorities does not change their CC plans, it only increases their expenditure; high community charges reflect overspending;

- the vast bulk of local authorities have other sources of income than the CC to meet actual expenditure: they could set higher than assumed fees or charges, make use of trading profits or turn to the significant balances and reserves available; (partly as a result of closedown of the old regime huge amounts are sitting around on deposit); such sources of income could amount to around 20% of total CC income;

- in short, one level of AEF is consistent with quite a range of outcomes on actual CCs - the choice is up to individual LAs; (this year we hope to have our own computer model of the local government finance system so that we are not at the mercy of dubious DOE projections);

- as a last resort, the Government has a power to cap community charges - if some authorities are taking political advantage to raise charges to an unacceptable level in order to embarrass the Government; in the short-term at least, before accountability can be made to work, capping may have a useful role to play in holding down actual CCs.

Safety net

15. The position on community charges (both the CCSN and actual) is much complicated, however, by the safety net. You will recall that in broad terms, the safety net will ensure that the burden on local taxpayers in 1990-91 (paid in the form of community charges) in any LA will be the same in real terms as the local tax burden in 1989-90 (paid in the form of domestic rates), assuming that the LA's spending also stays constant in real terms. In practice, this will be achieved through the distribution of Revenue Support Grant. It was also agreed by E(LF) that the safety net should be self-financing ie no Exchequer contribution, so that gaining areas (relative to the no safety net position) compensated the losers.

16. Within Revenue Support Grant* the needs element would normally be distributed in proportion to each authority's GRE. But the safety net effectively overrides the GRE system and distributes revenue support grant so as to achieve the transitional objective described above. In practical terms, this means that in 1990-91 the CCSN is only a theoretical long-term CC for LAs; in reality, if an LA spends at need (ie = GRE), the CC would be the CCSN + safety net adjustment. (Some examples are shown in annex D.) These CCSN + safety net figures will be identified for each authority on the Community Charge Demand Note sent to each household. So like the CCSN itself, they are a central government responsibility.

17. The importance of this is that we can readily envisage E(LF) taking a two-stage approach to the negotiations. The first part would be as in approach A - to determine the CCSN. But the second part would be to exemplify the CCSN + safety net figures for each authority or group of authorities. This will highlight two problems: the high starting CC in inner London (which will rise further in subsequent years) and the high starting CCs in the

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*RSG payment to an individual authority comprises a needs element paid in proportion to its assessed need to spend (=GRE) and a small standard element paid as a lump sum per adult.

South-East (which will then fall). Some preliminary soundings within DOE indicate that they wish to look at changes in the safety net arrangements in order to improve the starting distribution of CCs. Anything more than tinkering would require an injection of Exchequer funds, ie more Revenue Support Grant which, under some transitional arrangement, would be directed at reducing the CCSN + safety net figure in selected areas.

Dangerous

Strategy

18. Against that background, our recommended strategy is therefore that you aim to concentrate the discussion on AEF, need to spend and the CCSN; and that your specific objectives should be:

(i) the minimum achievable amount of AEF.

(ii) the minimum achievable assessed need to spend;

[(iii) the maximum politically defensible CCSN;]

not a Tsy objective per se; follows from (i) & (ii)

(This combination reflects the simple equation: AEF = assessed need to spend - (CCSN x population).+)

On the safety net, our proposed strategy is to avoid changes to the existing agreed safety net, unless they can be contained within a satisfactory outcome on AEF (ie objective (i)).

+In full the equations are:

i) AEF = assessed need to spend (net of interest income, fees and charges) - (CCSN x population)

ii) AEF = actual revenue spending - relevant grants not in AEF - transfers from balances - (actual CCSN x population).

19. The main area of difficulty is all too clear. Both the objectives and the weights attached to the variables will be different for other members of E(LF). We expect all Departments (and the Prime Minister) will argue for a low target CCSN; and a high assessed need to spend. Several Ministers will see AEF, even though it is crucial for public expenditure, as the residual.

20. Although the balance is very hard to predict, it may be the Prime Minister, the "neutrals" on E(LF) and to some extent Mr Ridley who argue most strongly for a low CCSN. Other Departments particularly Education, Home Office, Health and Transport will of course support that. But they may concentrate their fire on getting the assessed need to spend up: their officials see the introduction of the CC as an opportunity for a one-off upward shift in needs (paid for by more Exchequer support).

21. You will wish to argue that AEF and need to spend are critical. (But it does not seem wise for you to argue that through to its logical consequence ie that the CCSN should be a residual.) In short a main tactic in the negotiations must be to avoid AEF becoming a residual and instead seek to persuade colleagues of its important wider implications for actual LA spending and hence GGE. Moreover if the balance on the committee is as indicated above, you should be able to find more support for keeping down AEF by focusing on restraining need to spend, than arguing up the CCSN.

22. It is helpful to look at each of these variables separately. The arguments are summarised below and set out more fully in the attached papers.

Detailed Strategy

23. Before setting out the detailed approach in terms of possible bid and your target and fallback position I should point out that all numbers are highly preliminary and not agreed with DOE officials.

24. First on AEF, you will face the conventional alignment of forces. The Treasury believes that higher exchequer support for local authorities leads to higher spending; DOE and Departments stick to the view that higher grant enables lower local taxpayer contributions. This will clearly be an important theme for the Treasury in the discussions. And LG take the view that the evidence of recent years tends to support our case (see paper A):

- local authority current expenditure has been growing in real terms since 1986-87;

- over the last few years, this growth has exceeded the growth rate in GGE; local authority current expenditure is contributing to the problems of the Government achieving it's overall objectives in terms of the GGE/GDP ratio; in earlier years LA current spending was part of the solution;

- the resumption of real growth in LA current spending in the mid 1980s coincided with the end of the strong downward trend in Exchequer support as a proportion of total local authority current expenditure ("the grant percentage") (see paper A);

- since the mid 1980s, the marginal disincentive to spend has been progressively reduced (in terms of different regimes): in 1989-90 such disincentives were abandoned altogether - and local authority spending bounded upwards by 4½% in real terms;

- from 1990-91 onwards there will again be no financial pressures at the margin, and as noted accountability cannot have any effect in that year; as recognised last year in E(LA) the absence of financial pressures at the margin requires a lower quantum of Exchequer support in order to restrain LA spending.

It will be important to focus this argument on the consequences of AEF for spending. DOE and others will see AEF in terms of reducing the CCSN: the arguments against that approach were set out earlier.

25. In the narrower context of AEF as a percentage of assessed need to spend, there are other useful points to make:

- there is no case for greater support to LAs as the CC is introduced: this belies the purpose of the new regime - the long term approach should be less taxpayer support and more local authority accountability:

- the political dangers of putting in excessive grant - "bailing out the poll tax"

- the wider pressures on the NPT means more AEF would limit the room for manoeuvre elsewhere in the Survey.

26. As yet, there is no indication of the likely bid from spending Departments/DOE. Our starting assumption is that they will look for AEF of around £24.1b - sufficient to finance an assessed need to spend which will maintain in real terms last year's budgets combined with a CCSN no higher in real terms than in 1989-90. That would represent a bid of +£2.5b on the 1989-90 figure equivalent to +£1.9b on the 1990-91 baseline.

ghastly numbers

27. Our provisional assessment is that a target objective on AEF for England in 1990-91 should be £22.6b, an increase of £400m on baseline and of £1.0b on the corresponding equivalent aggregate for 1989-90. This would maintain AEF in real terms.

28. It is worth noting that within this AEF figure, RSG would then be cut in real terms. In part, this is because there is likely to be a real increase in police specific grant within AEF. But the main reason is that NNDR income is likely to be more buoyant (because the NNDR poundage is to be uprated by the 1989 September RPI inflation) than AEF as a whole (uprated by the 1990-91 GDP deflator). There is no forecast of the September 1989

6·3% in last profile

RPI available to LG at this stage: but if we assume buoyancy of 1% and an September-September RPI change of 6½%, then NNDR income would rise by 7½%. AEF would rise by 4% if uprated by the present forecast GDP deflator for 1990-91 though that figure might privately have to be acknowledged as a little too low in the E(LF) discussions). (It will of course be important to resist any suggestion from Mr Ridley that the uprating on the NNDR poundage should be less than suggested by the September-September RPI.)

29. The fallback objective would be an AEF of £23.1b, an increase of +£900M on baseline and £1.5b on 1989-90. This would amount to a very small addition to grant (RSG and the relevant specific grants) in real terms (around 1½%). It would also allow local authorities to retain the benefit of the real buoyancy in NNDR income.

Mustn't accommodate

30. Second, on assessed need to spend, there are very real demographic (more old people etc), policy (community charge collection costs, abolition of ILEA) and relative price effect (police, fire and LA manuals wage increases) upward pressures on the need to spend in 1990-91. These are described in full in Paper A.

31. Departments will press strongly for a step upward in needs. But there are good counter-arguments for holding back (set out more fully in paper C):

- there is no justification for a steep increase in 1990-91 in assessed need to spend; indeed last year there was a one-off upward adjustment in the figure; it has been accompanied by a substantial real increase in local authority spending;

- any such increase now would be interpreted as a signal to spend up under the new regime;

- the aggregate need to spend must be held down, so that only a very small proportion (probably less than 10%) of local authorities could reasonably be expected to budget within it: there is clear evidence from the behaviour of Scottish local authorities, when the community charge was introduced this year, that the publication of need to spend figures for each authority became minima even for previous low spenders (see separate annex C);

- the evidence of scope for further efficiency savings identified by the Audit Commission must be reflected in the assessed need to spend;

- the new powers to set fees and charges under this year's Local Government and Housing Bill will be available for 1990-91: this should lead to higher LA income (which is netted off the measured assessed need to spend);

- the new requirement to contract out more services should reduce costs and hence revenue expenditure.

32. There is an awkward gap in perception here. Departments will regard need to spend (equal by definition to aggregate GREs) as a concept close to old-style provision - what central government planned for LAs to spend. We think of it as defining best-practice, a target for LAs to aim at. Consequently, the bid from Departments - though it may be derived by a bottom-up service by service approach - is likely to be framed in terms of sustaining LAs budgets in 1989-90. Even on a zero real growth basis, this gives a figure of £33.1b.

33. Although we cannot hope to ignore wholly the 1989-90 budgets (though even a partial recognition amounts to validating past overspending), we should stick to the proper interpretation of need to spend ie GREs not actual spending and take the 1989-90 GREs as the starting point. Accordingly our view is that your target should be to confine the needs figure to a small real increase in GREs ie a number around £31.7b (giving a small cash increase on this year's budgets adjusted for functional changes).

34. The fallback would be a slightly larger cash increase on LAs 1989-90 (adjusted) budgets ie £32.1b. An attractive presentational point is that this fallback taken along with the fallback AEF proposal can be presented as broadly maintaining the grant percentage, ie the degree of Exchequer support for local government, newly defined as the ratio of AEF: assessed need to spend (the only ratio anyone will be able to work out in July). This should make the package more attractive to Mr Ridley.

35. Third, there is the issue of the community charge for spending at need. As recognised at earlier discussions, the Treasury is likely to have very little support indeed for a tough line on this. All except Treasury members of E(LF) will see a case for keeping the CCSN (and by extension actual CCs) fairly low. But there are some points which you can make for sustaining the figure at a reasonable level:

- the Government has published a figure of £240 as the CCSN for 1989-90: it should not cut that figure in real terms; it will be politically very difficult this side of the General Election to let the CCSN rise in real terms; the Government should not prejudice overall targets on the GGE/GDP ratio, cuts in income taxes etc by building in an increasing burden of higher AEF on the taxpayer for several years to come.

- as with the assessed need to spend, there is no need for a downward shift in the burden of local taxes; any such move would damage the scope for future cuts in income tax;

- the CCSN must be credible: the actual CC in Scotland this year is £281 equal to £295 in constant real terms for 1990-91: figures below £250 in England will not be believed.

36. But this is unlikely to be fruitful ground for the Treasury to contest. Our guess is that a figure which maintains the community charge for spending at need broadly at the same level in real terms as the figures already published for 1989-90 is the best achievable outcome. Accordingly the proposed target is £252 (in practice, a range would be quoted anyway of perhaps £240-£265).

37. But dropping just £2 off this (the consequences for AEF are reflected in our fallback figures) leads to a cash figure of £250 for the first year of the CC. E(LF) may well find such a figure politically very attractive and this is the basis of both the bid and fallback position.

38. Finally, there is the question of the Treasury strategy on the safety net. At this point, we can only speculate on what changes DOE might propose to the safety net arrangements and what the Exchequer cost in terms of extra RSG might be. But the obvious line initially might be as follows:

- no case for tinkering with the safety net; E(LF) agreed on its broad shape last year;

- firm agreement, endorsed by the Prime Minister, that the safety net would be self-financing - is Mr Ridley going back on that now?

- safety net in Scotland is self-financing: too late to change plans.

nonsense!

39. That said, however, this line is far from convincing. Given the degree of public criticism of the new policy in advance of its introduction, the political appeal of feeding through more of the benefits under the policy earlier in the winning areas is all too clear. In particular, we imagine DOE will wish to pursue ideas of cutting the CCSN plus safety net in the South-East, by channelling more RSG to such areas. (We are not at all sure this can be done, without primary legislation: neither are DOE.) But E(LF) is likely to find this attractive.

40. However, if a technical means can be found the Treasury has no particular reason to resist changes to the safety net, provided the cost can be contained within a total equivalent AEF that does not increase the degree of support for local authorities. So in practice, the eventual Treasury strategy might be better pitched at seeing whether within an agreed AEF more RSG can be directed at keeping down the CC + safety net in certain areas, particularly the South-East. But we will need to consider all this further as we learn more about the DOE strategy.

nsg

Tactics

41. We understand that the Prime Minister is anxious to hold a meeting with you, Mr Ridley and Mr Parkinson just before the second Bank Holiday in May. That is intended to be a ground clearing exercise; but it could lead to a much broader understanding amongst all parties. We will need to consider the tactics of this particular meeting further when we discuss the strategy with you on 3 May.

42. More generally, it seems to us that the best approach may be to seek a co-ordinated approach with Mr Ridley. Indeed a meeting with him prior to the Prime Minister's meeting might be advantageous. No-one else on E(LF) - even I fear those without strong departmental interests - looks a likely potential ally, with the exception of the chairman of E(LA). At official level, we will need to sound out DOE to test their likely line. But the fallback package along the lines set out in paragraph 44 below might just about be acceptable to Mr Ridley - if he can be persuaded either not to change the safety net or to contain the costs within that AEF total.

43. However, you will not wish to put forward even the target package as the opening offer. You will wish to give further thought to the precise tactics: but our instinct is not to go for a tough approach - because it will not be credible. On the other hand, you will wish to aim off initially, so that the target package can emerge on the basis set out below.

Conclusion

44. Our view is that you should seek to focus discussions on the assessed need to spend, AEF and the community charge for spending at need; and our inclination is that you should resist any move to put an Exchequer contribution (ie more RSG) into the safety net, unless it can be contained within an acceptable DOE total. The objectives will be to minimise AEF by aiming for the maximum politically acceptable community charge for spending at need and the minimum assessed need to spend. Our preliminary assessments of Departmental bids targets and fallback for each of these variables as realistically achievable goals is as follows:

	Bid	Target	Fallback
CCSN	£250	£252	£250
Need to spend	£33.1b	£31.7b	£32.1b
AEF of which:	£24.1b	£22.6b	£23.1b
i) NNDR	£10.3b	£10.3b	£10.3b
ii) Grant	£13.8b	£12.3b	£12.8b

	Bid	Target	Fallback
Memo items			
AEF on 1989-90	+£2.5b	+£1.0b	+£1.5b
on 1990-91 baseline	+£1.9b	+£400m	+£900m
Grant on 1989-90	+£1.8b	+£300m	+£800m
on 1990-91 baseline	+ £1.5b	-	+£500m

45. You may like to discuss the following issues with us on 3 May:

			Paragraphs
i)	the overall Treasury objectives;		4-8 & 18-22
ii)	the proposed negotiation framework;		9-17
iii)	the specific objectives on	- AEF	24-29
		- Need to spend	31-39
		- the CCSN	35-37
		- the safety net	38-40
iv)	the tactics for handling E(LF)		41-43

(You may also wish to resume the discussion on the shape of the settlement for years 2 and 3 - my submission of 28 February refers.)

Barry H. Potter

BARRY H POTTER

ANNEX A

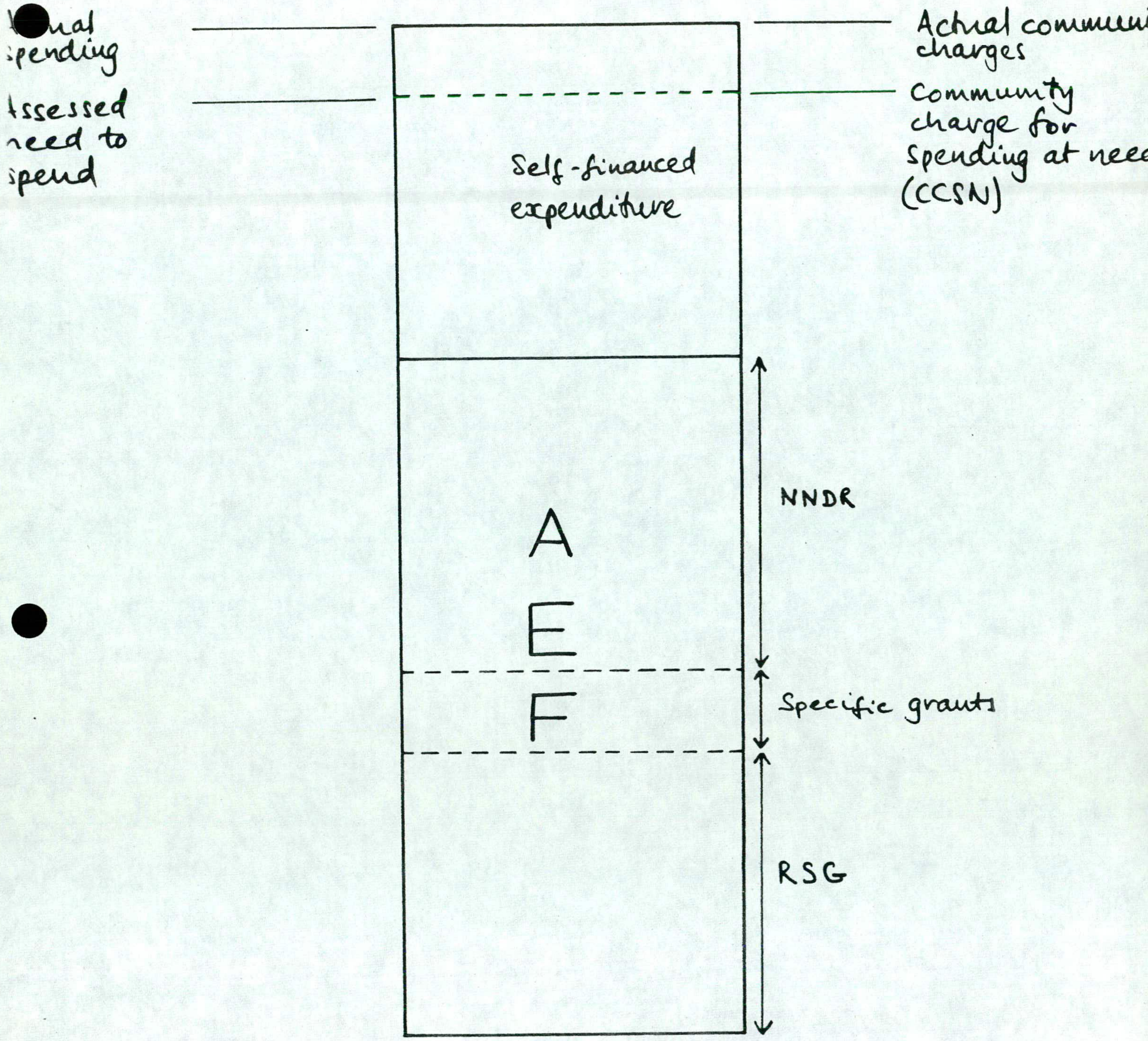
TREATMENT OF LA CURRENT EXPENDITURE IN 1989 SURVEY: PROPOSED TIMETABLE (ASSUMING A JULY GRANT ANNOUNCEMENT)

1989

Jan-Feb	Chief Secretary letter leading to agreement on procedures and baselines.
Mar-June	Official level discussions on changing needs with local authority associations.
May-June	Officials prepare and discuss papers, eg in PESC(LA).
June-July	Collective Ministerial discussion of: a. "Aggregate Exchequer Finance" (AEF) comprising the revenue support grant (RSG), the national non-domestic rate (NNDR) and certain specific revenue grants; b. aggregate needs assessment; c. (following from a. and b.) the community charge for spending at need; d. expected actual levels of community charge implied by different grant levels.
July	Announcement of AEF for 1990-91 together with the aggregate needs assessment and the community charge for spending at need.
Sept-Oct	a. Service split of aggregate needs assessment settled for 1990-91. b. Bilateral Ministerial discussions of specific grants in the Survey, for all three Survey years.
Oct	Business rates package and RSG for 1990-91 settled and announced for Scotland. Difficult to avoid parallel announcements on 1990-91 NNDR and RSG and aggregate specific grants for England and Wales. Environment departments begin formal consultations on RSG. Final decisions on specific grants for later years and projections of total LA self-financed expenditure, capital and current.
Nov	Autumn Statement.

Local Authority Current Expenditure

Annex B



ANNEX C

COMMUNITY CHARGES IN SCOTLAND IN 1989-90

Facts

1. Average community charge (excluding water) is £281.

2. Average community charge (including water) is £301.

3. Range of community charges goes form £148 (Orkney) to £392 (Edinburgh City).

4. Increase in community charge over average domestic rate bill per adult in 1988-89 is 14% - an increase in real terms of 8%.

5. Spending in 1989-90 over 1988-89 showed an increase of 12% - an increase in real terms of 6%.

6. Some regions increased spending in 1989-90 by up to 13½% and Districts by up to 30%.

Implications

1. Local authorities have taken the opportunity to use the Government's community charge policy as an excuse to increase spending.

2. Increased spending not necessarily confined to high spenders, moderate spenders have spent up as well.

3. Only indications of restraint are where authorities have tried to keep charges below psychologically important levels. For example Edinburgh wanted to keep below £400.

4. Generally accountability has not obviously been improved. But there is no reason why it should.

- There are no elections in Scottish districts until 1992.

- Comparisons are blurred because of the "safety net".

- Difficult to compare the new system with the old domestic rating system.

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PAPER A: FACTUAL BACKGROUND

Trends in spending and grant

In the first two years of the present government, local authority spending grew about twice as fast as GGE in real terms. From 1982-83, however, the system of targets and penalties led to a considerable slowing of growth, and the introduction of rate-capping contributed to a substantial real fall in spending in 1985-86. But the abandonment of targets and penalties for 1986-87 led to a substantial real increase of over 6 per cent, and the step change in teachers' pay meant there was a further significant real increase in 1987-88. Spending barely grew at all, in real terms, in 1988-89, as local authorities (like everybody else) underestimated the pick-up in inflation and most of the catching-up for restraint in the past, including on pay, had taken place.

2. This year, by contrast, the real increase in spending looks likely to be around 4½ per cent. There are a number of possible reasons for this. Local authorities may be catching up for last year's inflation, and budgeting on the basis that future inflation may be ahead of the GDP deflator. Also, the closedown of the old RSG system meant a more generous grant settlement than in most years, which local authorities know will be paid in full, as planned, irrespective of the level of spending.

3. In short, from 1982-83 to 1985-86, local authority spending grew more slowly than public expenditure as a whole (GGE excluding privatisation proceeds); but since 1986-87, it has grown significantly faster than GGE. And one of the key differences has been the easing of pressure through grant settlements.

4. Annex A gives the figures in detail.

Pressures on local authority spending in 1990-91

5. Local authority current spending is likely to show real growth in 1990-91. Our forecast of local authority spending is likely to be based on an assumption about the GDP deflator in 1990-91. The FSBR included a figure of 4 per cent but given that current RPI inflation is running close to 8 per cent, it is unlikely that E(LF) will accept a figure of 4 per cent in July. These papers assume that the forecast GDP deflator will be increased slightly before July - enabling us to use a more realistic figure and helping to maintain credibility in E(LF). The papers assume a GDP deflator of 5 per cent.

6. The main pressures on spending in 1990-91 are outlined in more detail in Annex B, but the major pressures will come from the following.

(a) Relative price effects.

The main impact will be through pay settlements that are above the assumed level of inflation of 5 per cent. In addition, manpower levels are likely to increase in certain areas (eg police). Pay accounts for about 75 per cent of local authority current spending, and is likely to account for an increase of about £500 million.

(b) Policy changes

The main policy initiatives include the additional costs of collecting the community charge (£100-200 million), the costs of transferring educational responsibilities from ILEA to the inner London boroughs (£100 million), and increased costs on personal social services (mainly as a result of the Disabled Persons Act 1986) (£100 million).

(c) Demographic changes

The main upward pressures are likely to be on personal social services and, in particular, on services for the elderly. Other pressures on community care, child abuse, poverty/homelessness, and AIDs will be partly off-set by lower unemployment, but can be expected to add to the overall pressure for increased spending on personal social services. In total they could all add about £100 million.

In total these could amount to upward pressure on needs of up to about £1 billion.

7. Against these upward pressures, the Audit Commission has identified a number of potential savings through efficiency gains. It is difficult to judge how far we will be able to get departments to accept that these savings should be taken into account. The savings are unlikely to feed through into any estimates of actual local authority spending but they should feed into the estimate of the aggregate need to spend. We have identified savings amounting to a total of about £2 billion, but these are based on reports compiled over a number of previous years and some will have already been taken into account. Assuming that those already accounted for amount to about £1 billion, we might expect further savings of up to about £1 billion to be taken into account in the calculation of the aggregate need to spend. It is perhaps more realistic to expect colleagues to accept savings of about £½ billion.

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PAPER B: OBJECTIVES

General objective

The common objective for this year's settlement will be to get the community charge off to a good start. A number of Ministers will equate this with maximising grant, so that the CCSN is as low as possible, and actual community charges not too high.

2. Alongside this general objective, different Ministers will see different things as important.

Spending departments objectives

3. The spending departments' objectives for the settlement are fairly straightforward. They will want a high figure within the aggregate assessed need to spend for their particular service. They will argue that we must include realistic figures for the need to spend, and that these should be built up from a "bottom-up" approach based on individual services. They will see this as the best way of achieving a higher figure for their service. Both we and (probably) DOE will argue that the aggregate should be set in the light of what the Government can afford but we can expect the usual arguments against this approach. This year, with the introduction of a new local authority finance regime and new Survey procedures, we can expect a more determined effort from the various service departments.

4. At official level DOE will be chairing the Settlement Working Group (SWG) which will report on changes affecting the aggregate need to spend in 1990-91 to the Consultative Council on Local Government Finance (CCLGF) (which is where Ministers meet local authority elected representatives). The SWG will focus on the Local Authority Associations views on changing needs but service departments are likely to take the opportunity to build on the work of the SWG to argue their own case for higher needs on their particular service. They will be concerned about two

points. They will wish to see both a larger total and a greater share of the total for their service. DES can be expected to take the lead - indeed they are already attempting to co-ordinate a paper from the main service departments for the E(LF) discussions. This is likely to argue for the "bottom-up" approach and will increase pressure for a higher total.

5. In short, the service departments will want the best of all possible worlds - a politically acceptable low community charge, financed by high grant, so that spending on their service can also be high.

6. Both we and DOE will need to stress the importance of continuing to restrain local authority spending. Others may argue that the community charge philosophy, and the introduction of the new planning total, suggests that the Government may no longer be concerned about total local authority spending. We will therefore need to reassert the point that total spending does matter and that the Government's overall public spending objectives must take priority.

DOE Objectives

7. DOE will be in a rather different position.

8. It is likely that DOE will be most concerned about the aggregate need to spend rather than about actual spending. This is the total that will be used to calculate the community charge for spending at need (CCSN). The aggregate need to spend less Aggregate Exchequer Finance (AEF) will lead to the CCSN. The CCSN will be the Government's estimate of what it thinks local authorities should be charging. It will be the figure that the Government will wish to emphasise in the run-up to the introduction of the community charge on 1 April 1990. DOE will be continually stressing that this is the figure that it believes the prudent local authority should be setting. It is therefore likely that, in discussions on AEF, DOE will be focusing on what this means for the CCSN. Their prime objective is likely to be a figure for the CCSN that will be seen as realistic.

9. DOE will however face a conflict. There are arguments for both a high and a low CCSN. A low CCSN will be held as politically important for a successful introduction of the community charge, but it must be realistic (a reasonable number of authorities will need to set their actual CCs below the CCSN). They will need to balance the arguments.

10. Given that it is the CCSN that will be foremost in their mind, there are a number of issues they will need to consider.

(a) They will want the CCSN to be presentationally acceptable. It is unlikely that they would accept a CCSN that was much higher in real terms than the equivalent figure in 1989-90 because this might be held as a criticism of the Government's community charge policy.

(b) On the other hand a lower CCSN might lead to a bigger difference between the CCSN and actual community charges. DOE will not want this gap to be too large because they will have to explain any difference by overspending. Too low a CCSN will discredit the concept. They may not therefore wish to see the CCSN set at too low a level.

(c) If they think that the Treasury is going to be tough on grant, then they will support our wish to see a lower aggregate need to spend. But again they would not support an unrealistic figure, because they have to justify it to the local authority associations. They may well, however, be an ally against other departments' desires to push up the aggregate need to spend.

(d) They will want some measure of the grant percentage to be no worse than it was in 1989-90. They will want to be able to claim that Government support to local authorities has improved, or at the worst, has remained unchanged. Annex C discusses the grant percentages further.

Treasury Objectives

11. Notwithstanding the changes in local authority finance and in the definition of the planning total, the two key objectives for the Treasury are the same as ever.

- For reasons of macroeconomic policy, we want to keep any increase in actual local authority spending to a minimum.

- And within that, we want to keep the size of the AEF envelope, ie grant, to a minimum, so as to keep down the burden on the taxpayer. This means that we want the CCSN to be as high as politically feasible.

12. These two objectives go hand in hand. Indeed, the level of grant is our main weapon to influence the level of local authority spending. Thus the central objective is a low figure for AEF.

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PAPER C: STRATEGY

Approach to the discussions

The way the discussions are handled could have an important bearing on the outcome.

2. Specifically, a number of Ministers will come to E(LF) expecting discussion to focus on the actual level of community charges that will result from the settlement. And obviously that will be high in everybody's minds throughout. But it cannot possibly help us for the discussions to centre on that.

3. Focusing on the doorstep community charge will lead to immense pressure for more grant, so that, for any given level of spending, the community charge is lower. This puts us immediately on the defensive. We can argue that local authorities will set whatever community charge they had in mind anyway, and that extra grant will simply mean higher spending. But we cannot refute the proposition that some authorities will use extra grant to reduce the community charge.

Dangers of actuals

4. It will be important, therefore, to focus the discussions, as far as possible on the numbers Ministers actually have to decide and take responsibility for: the aggregate need to spend (NTS), AEF, and the CCSN. We suggest that you might talk to the Prime Minister about this in advance (see paper D on tactics). The points are:

- clearly it is vital to get the community charge off to a good start, and the settlement must be defensible, to that end;

- but Ministers do not fix the doorstep community charge - that is what accountability is all about;

- so what we have to do is to concentrate on the numbers we do control - the NTS, AEF, and the CCSN;

- remembering that we have the fallback weapon of community charge capping for local authorities.

5. The aim is thus to focus the debate on needs, rather than actual spending and charges. The rest of this section therefore looks first at the arguments on needs, and then at arguments on actual community charges.

The matrix on needs

6. The relationship between the NTS, AEF, and the CCSN is straightforward. The CCSN is the difference between the need to spend and AEF, divided by the total number of community charge payers (assumed at 36 million for 1990-91). Looked at another way, if the CCSN is fixed, the difference between that and the NTS has to be met by grant.

7. Thus discussions will centre on a matrix which shows a range of figures for the need to spend, a range for AEF, and the figures for the CCSN which would result from the various combinations of the two. A first shot at such a matrix is below.

Values for CCSN (£) in 1990-91

		Need to spend (£bn)					
		31	31.5	32	32.5	33	33.5
	22	250	264	278	292	306	319
AEF	22.5	236	250	264	278	292	306
(£bn)	23	222	236	250	264	278	292
	23.5	208	222	236	250	264	278
	24	194	208	222	236	250	264

In terms of objectives,

- we want a low AEF, and preferably low NTS - that means an outcome as near the top of the matrix as possible, preferably over to the left;

- spending departments will want a high NTS, financed by grant - that means an outcome as far over to the right as possible, preferably towards the bottom;

- DOE, with their balance of objectives, may want to end up somewhere in the middle.

8. In practice, the element in the equation with least flexibility is likely to be the CCSN. Political considerations will put a cap on this, and the maximum politically acceptable level may well emerge fairly early on in the discussions.

9. We think there is absolutely no case for the CCSN to be below the figure DOE have quoted for this year, of £240, in money terms (though this has been worked out on slightly different assumptions from the CCSN, notably a larger population). Uprating that for inflation at 5 per cent would give a figure of £252. Beyond that, you could argue that, if colleagues see a case for a real increase in the need to spend, some of the extra cost of that should properly fall on the chargepayer. But there seems little prospect of the CCSN being set above the cash level of domestic rates per head in 1989-90, of around £275. A figure of £260 may be a more realistic upper limit.

10. This constraint means that, above a certain limit for the CCSN, additions to the NTS have to be paid for through extra grant. In practice, it will therefore be vital to discuss the NTS and AEF together - otherwise, Ministers may become hooked on a very high figure for the NTS, which would mean a high outcome for AEF. Here, we have looked at the arguments on the two separately, and then pulled together the bull points of our case.

Need to Spend

11. The level of the need to spend (NTS) could be set in two ways:

(a) based on aggregate measures of spending in 1989-90, either the need to spend (aggregate GRE), or actual local authority budgets;

(b) by a "bottom up" approach, which seeks to work out the amount that ought to be spent by an efficient authority on each element within the needs assessment, service by service, and adds them all up. This is the approach favoured by the spending departments, and they are working up a paper for E(LF).

We think you should be able to see off the "bottom up" approach, be stressing how useful it will be when it comes to discussing the service distribution in the autumn, and ignoring it for now. The more difficult question is whether the NTS should be based on a percentage increase over needs (as we shall argue) or over budgets (as spending departments will argue). We should be able to succeed in basing it on needs, on the grounds that the other approach validates local authority overspending. But in practice, the level of budgets in 1989-90 will limit the room for manoeuvre on the NTS - the cash figure for budgets in 1989-90 may turn out to be a floor, politically, under the NTS.

12. Simply uprating needs by 5 per cent and adjusting for the factors covered in Annex E, would give a total of £31.7 billion. This would be a very good outcome if it could be achieved. A more realistic objective might be to limit the real growth of the NTS to around 3 ~~2½~~ per cent. This suggests a figure of £32·1 billion, which would imply a ~~small~~ cash increase, but a real cut, on 1989-90 budgets (adjusted for functional changes).

13. A number of colleagues are bound to argue for more substantial real increases, pointing to:-

- the upward pressures on their particular service, and on local authorities generally;

- the case for greater realism under the new system, particularly since the Government has to determine the "need" to spend to deliver services, and the NTS could be subject to judicial review;

- the need to get the community charge off to a good start.

Against this you could argue:

- there is absolutely nothing in the new system which implies a step change in the amount local authorities need to spend to deliver services;

- indeed, the community charge is about getting spending down, not an excuse for putting it up - to suggest the reverse would give all the wrong signals to local authorities;

- the prospect that the NTS will lever up actual spending: the traditional overspenders will ignore it, but, as the Scottish experience shows, some authorities which have traditionally spent below assessed need may take the opportunity of the new system to move up to that level - we shall look at this further in modelling the impact of different levels of NTS on different authorities;

- on upward pressures, local authorities have had time to prepare for most of the new functions coming through in 1990-91, and any supposed extra costs should be met by use of the balances they have already built up for the purpose - not reflected in a yet higher NTS and higher grant;

- there is still considerable overspending and inefficiency, (where you could refer to the Audit Commission's work);

AEF

14. There are two sets of arguments for keeping grant down: first, based on the share of the NTS that should properly be financed by the taxpayer; and second, on the influence of grant on actual spending.

15. On grant and needs:

- there is no reason for a higher level of taxpayer support for local authorities;

- indeed, the long term objective should continue to be less taxpayer support and more local authority accountability;

- there are actually political dangers in putting in excessive grant - the Opposition will describe any apparent new generosity to local authorities as the Government running scared and "bailing out the poll tax";

- the public expenditure position means that high levels of grant, within the NPT, cannot be afforded, or, at any rate, would seriously limit any room for manoeuvre elsewhere in the Survey.

16. The arguments on grant and spending are:

- higher grant leads to higher actual spending - this is the lesson of the change between the mid-1980s (tough grant settlements - real cuts in spending) and more recent years, especially 1989-90, including the Scottish experience of 1989-90, where a grant increase of 5.5 per cent, ahead of that for England or Wales, did not prevent spending rising by 11.6 per cent;

- higher grant is no guarantee whatever of lower actual community charges: many local authorities will have a "target" for the community charge, and higher grant will simply be added to that, leading to higher spending; in any case, the relationship between grant and community charges will be obscured by the use of balances, and other income - in Scotland, community charges rose even faster than spending;

17. In assessing the appropriate objective for AEF, we have looked separately at the NNDR and grant (taking RSG and specific grants together).

18. The level of NNDR is more or less given. Mr Ridley has said that the amount raised from non-domestic rates paid by the private sector and nationalised industries will be broadly the same, in real terms, in 1990-91 as in 1989-90. The real terms increase should follow the September RPI - this helps us since that will be significantly higher than the GDP deflator for 1990-91, which, we shall be arguing, is the appropriate measure of inflation for spending purposes. The other element in the NNDR is the Government contribution in lieu of rates, which is also likely to be buoyant. So there should not be much to negotiate about, unless Mr Ridley argues for a cut in the burden on the business ratepayer. We think you should resist this, but Mr Ridley will probably concentrate his fire on other things. A preliminary estimate suggests that the amount of NNDR may be around £10.3 billion.

19. As far as grant is concerned, the total of RSG and specific grants within AEF in 1989-90 amounts to around £12 billion. This represents, in effect, the taxpayer's support for local authorities.

20. AEF in 1989-90 would be around £21.6 billion. Increasing in line with 5 per cent inflation would give a figure of £22.7 billion. With the NNDR buoyant, this would imply a small cash increase in grant of £0.4 billion but a small real cut.

21. However, with the CCSN held constant in real terms at £252 (producing around £9.1 billion), it would provide for an NTS above our target of £31.7 billion. So we believe that our target should be an AEF of £22.6 billion.

22. The fallback position could be to go for the 3 per cent real increase in the NTS, to £32.1 billion, and a CCSN of exactly £250, implying AEF of £23.1 billion (a 2 per cent real increase) and grant of £12.8 biullion (a 1½ per cent real increase).

23. With the NNDR given (certainly as far as the upper limit is concerned), any upward pressure on AEF means more grant, at the taxpayer's expense.

24. To summarise, the two possibilities we have suggested work out as follows:

Possible Settlement

	Target £ bn	Fallback £bn
NTS	31.7	32.1
CCSN	9.1	9.0
AEF	22.6	23.1
(of which NNDR)	(10.3)	(10.3)
(grant)	(12.3)	(12.8)
Increase over 1989-90		
- AEF	+1.0	+1.5
- grant	+0.3	+0.8

X

25. It is worth noting - though unlikely to be relevant in practice - that the safety net effectively puts a floor under AEF. Basically, it ensures that, if an authority simply increases its budget in line with inflation, it will not have to raise any more, in real terms, from the domestic rate payer/charge payer in the first year of the new system than in the last year of the old system. In effect, this means that, assuming budgets do not fall in real terms, AEF cannot fall either. This floor is likely to be of the order of £22½ billion. The safety net will have a more important bearing on the distribution of grant, and this is considered in Annex D.

26. As you know, the aim is to settle specific grants within AEF before the July settlement, as far as possible. We shall have to decide how best to handle specific grants when the bids come in.

If there is strong upward pressure, it may be to our advantage to discuss them collectively in E(LF), with support expected from Mr Ridley. But we shall have to judge that as we go along.

27. To sum up, the bull points of the Treasury's case on the NTS/AEF/CCSN nexus are:

- we need to stick to the ten year policy of downward pressure on local authority spending;

- the community charge is designed to help this, not an excuse to backtrack;

- higher grant would lead to higher spending, not lower community charges;

- a reasonable settlement would be for Exchequer support to remain constant in real terms, so that a small real increase in the NTS can be achieved with no real increase in the CCSN.

Actual community charges

28. The implications of the settlement for the community charges that authorities actually decide to levy are bound to feature in the discussions. As noted above, some colleagues may even feel that the discussion should focus on the effects of the settlement on actual community charges.

29. Colleagues are bound to ask what the settlement means for actual community charges. But a discussion on actual community charges is likely to mean that we will be forced into a more generous settlement. Local authority budgets in 1989-90 (adjusted for functional changes) amount to £31.6 billion, and it could be argued that a realistic forecast of actual spending in 1990-91 would be about £34.1 billion ie a real increase of 3 per cent. Using an AEF figure of £23.1 billion (our fallback position) this would imply an average community charge of £306. This is 12 per cent higher than the rate bill per head in 1989-90 of £274. However this figure (£274) assumes that local authorities use balances of about £600 million to finance spending. (This is the amount by which local authorities plan to reduce balances in 1989-90). If we assume that a similar reduction of balances takes

place in 1990-91, the forecast of the average community charge would be reduced to £290. This would represent a 6 per cent increase on 1989-90.

30. We are sure that generally it is in our interests to minimise any discussion of actual community charges, and to concentrate on the figures that the Government can control, not those it can't. But it is unrealistic to suppose that the discussion will stop there. And so it is important to bear in mind the arguments that we do have at our disposal if colleagues' concerns about the level of actual community charges begin to dominate.

31. There are two:

(i) our ability to cap community charges, to protect the charge payer; and

(ii) our ability to shift the distribution of grant to benefit some types of authority (eg those in Outer London, the South).

Each addresses different concerns. The first relates to the prospect of very high community charges in some individual areas. The second to the fact that the financial benefits the new system will eventually bring to the South and Outer London will be delayed for several years by the slow phasing out of the safety net (see Annex D). We shall almost certainly want to use (i); we may also want to use (ii) - though probably not without bilateral discussions with DOE beforehand.

32. The practical arguments for <u>community charge capping</u> are strong. Community charges will tend to be particularly high in Inner London: colleagues are likely to be especially worried about the political (and social) implications of this. Charge capping will help to protect the chargepayer in these areas, and to contain the social problems caused by the introduction of the new system. Capping may also be necessary simply to prevent excessive overspending - particularly in the early years of the new system, before the accountability effect of local elections can be brought to bear.

33. Some colleagues may argue that capping would be at odds with the logic of the new system - which is that local authorities should make their own decisions about the level of local taxation and that Central Government should not interfere. It is in our interests to argue strongly against this view. We need to emphasise that:

- of course, the main aim of the new system is to enhance local authorities' accountability and to make sure that local decisions on the level of spending are properly reflected in the level of the local taxation.

- but accountability will not bite immediately, and the Government cannot walk away from its ultimate responsibility to protect charge payers from irresponsible local authorities, where an authority sets its charge at a ridiculously high level or where it plans to finance excessive overspending.

- we decided to include a charge capping power in the legislation because of this responsibility. We must be prepared to use it now, to protect local people and to prevent serious social consequences of local authority folly.

34. The other argument at our disposal - <u>varying the distribution of grant</u> - is likely to prove less important. DOE are concerned that the safety net (which will phase in losses and gains in authorities' income as we move from the old to the new systems) will delay gains for the South and Outer London. They may press for more of these gains to come through in 1990-91, with the cost met by extra grant, rather than by altering the phasing in of losses for authorities in Inner London and the North.

35. If the prospect of relatively high community charges in Outer London and the South is a major concern for DOE, it may be that we could secure a cheaper settlement overall by agreeing to finance some of these gains directly: the alternative might be having to make a larger addition to AEF to reduce community charges in general. It is however, difficult to estimate the likelihood that we may have to do a deal of this kind.

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PAPER D: TACTICS

If you agree with our analysis above, there are then questions about the general approach and the tactics, that will produce the most successful outcome.

2. On the general approach, there is the usual choice between, on the one hand, starting with very low proposals for NTS and AEF, in the expectation of being bid up to where we expect to end up, and, on the other hand, starting only slightly below the likely outcome. In the circumstances of this year's discussions, we recommend the latter approach. If you appear to be taking an unrealistic position at the outset, the credibility of our arguments could be undermined, and the eventual outcome worse than it would otherwise have been.

3. On tactics, there are four audiences to consider: the Prime Minister; Mr Ridley; the spending Ministers; and the 'neutrals' on E(LF). Several approaches seem to be open to you:

- take an independent Treasury line in E(LF);
- seek to persuade the Prime Minister of the Treasury case in advance of E(LF)'s first meeting; and
- attempt to reach a broad measure of agreement with Mr Ridley, also in advance of E(LF).

No doubt you will wish to consider which approach is most promising - the second and third could go together.

4. The Prime Minister has, we understand, decided to hold a meeting with you, the Chancellor, Mr Ridley, and Mr Parkinson before the second Bank Holiday in May. This meeting may just be intended to bring her up to date on the issues that have to be decided in E(LF); but with some preparation beforehand, it might be possible to reach broad agreement between the main parties before E(LF) meets, either at that meeting or shortly afterwards.

5. We would see some advantage in such an early agreement, if it proved possible. For that to be the case, it would of course be necessary to find out more about Mr Ridley's thinking quite soon. Mr Ridley is likely to be our closest ally; certainly none of the spending Ministers will offer any help. And once the discussions have passed to E(LF), we may well find ourselves heavily outnumbered.

6. If the major issues do have to be resolved in E(LF), it may be worth taking some of the 'neutrals' through the decisions beforehand. Mr Parkinson may have some special influence, as chairman of E(LA), and he is a potential ally. You may also want to have a brief word with others who may be sympathetic: perhaps Mr Wakeham, Mr Fowler, and Mr Newton. Perhaps the key point to get across is that, although it will be important to get the community charge off to a good start, it will be equally important to maintain the continuity of the Government's policy of reducing local authority spending.

7. We do not however, see any point in pre-meetings with any of the spending Ministers.

ANNEX A

LOCAL AUTHORITY SPENDING AND GRANT, 1981-82 TO 1989-90

	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1988-89 (ex Polys)	1989-90
GDP deflator	74.281	79.54	83.225	87.337	92.12	95.219	100	107.25	107.25	113.149
Relevant Expenditure (O)	19,933	21,765	23,005	23,900	24,039	26,370	28,704	30,877	30,042	33,156
Rel.Exp.(Real) m pnds	26,835	27,364	27,642	27,365	26,095	27,694	28,704	28,790	28,011	29,303
Real change %		1.97	1.02	-0.01	-4.64	6.13	3.65	0.3	n.a.	4.61
GGE(ex pp)(Real) bn pnds	162.9	167.3	170.1	174.9	174.6	177.3	177.0	173.5	173.5	176.4
Real change %		2.7	1.67	2.82	-0.17	1.55	-0.17	-1.98	-1.98	1.67
AEG(S) m pnds	10,900	11,500	11,800	11,900	11,800	11,800	13,000	13,775	12,940	13,575
AEG(S)(Real) m pnds	14,674	14,458	14,178	13,625	12,809	12,392	13,000	12,844	12,065	11,997
Real change %		-1.15	-1.94	-3.9	-5.99	-3.26	4.91	-1.2	n.a.	-0.5
AEG(O) m pnds	10,900	11,200	11,500	11,900	11,785	11,961	12,744	13,204		13,575
AEG(O)(Real) m pnds	14,674	14,081	13,818	13,625	12,793	12,562	12,744	12,311		11,997
GRE m pnds	17,194	18,358	19,156	20,003	21,237	22,952	24,237	26,015	25,180	27,662
GRE(Real) m pnds	23,147	23,080	23,017	22,903	23,054	24,104	24,237	24,256	23,478	24,447
Real change %		-0.3	-0.3	-0.5	0.7	4.6	0.6	0.0	n.a.	4.1
Grant percentage (S)	59.1	56.1	52.8	51.9	48.7	46.4	46.4	46.2	n.a.	43.3
Grant percentage (O)	54.9	51.7	49.8	50.0	49.0	45.4	44.4	42.8	41.2	n.a.

ANNEX B

PRESSURES ON LOCAL AUTHORITY SPENDING IN 1990-91

There will be a number of upward pressures on local authority spending in 1990-91 as a result of new policy changes (based on central government initiatives) and the rising cost of existing policies (because of demographic factors such as an increased elderly population and pay pressures). The main pressures in each of the main services, (other than pay which is covered separately), and a very crude assessment of the likely cost, are as follows:

(a) Education

The number of school children is projected to decline over the next few years but given the tendency towards a reduction in class sizes the number of teachers is unlikely to decline. As long as a teacher shortage exists the main pressures will be for increased pay (see later paragraph on pay). The transfer of education responsibilities in inner London from ILEA to the inner London boroughs is unlikely to reduce costs. Even though ILEA is considered a large over spender the cost of education in inner London is likely to be higher in 1990-91. A crude guess suggests that additional spending could be of the order of £100 million. Further pressure on educational needs, from the national curriculum for example, could add another £10-20 million.

(b) Transport

On roads there will be increased pressure for higher spending on structural maintenance. Some of this pressure could be removed by capitalisation, or from re-classifying the expenditure to capital spending, but if neither of these changes occur increased spending could amount to anything up to £150 million, say likely to be about £50 million.

(c) **Law and Order**

The main pressures within the law and order programme will arise on the pay front (police, probation services and magistrates courts) and these are covered later. Additional pressure will also arise for increased manpower. For the police this is likely to amount to an extra 1 per cent (£40 million), so law and order in total could add about £50 million.

(d) **Personal Social Services**

Demographic changes could lead to additional spending of about £30-40 million, mainly concentrated on the elderly. Pressures arising from community care policies could add a similar amount but this could be larger if action on the Griffiths report is implemented. Other pressures, for example on child abuse could add a further £20-30 million. Additional pressures will also arise on poverty/homelessness and AIDs but these could be offset in part by falling unemployment. A number of policy changes could lead to higher spending - Disabled Persons Act (up to £50-£150 million), Children Bill (£5 million), Data Protection Act (£2 million) and other changes such as improved standards in residential care, more training, etc. (£10-20 million). In total increased spending on personal social services could amount to up to £300 million, say likely to be £200 million.

(e) **Other environmental services**

Community charge collection costs will be higher than the collection of rates, this could amount to between £100-200 million. Other pressures will arise from improvements in air pollution systems (£20 million), improvement in waste control systems (£20 million), and possibly increased responsibility as a result of the privatisation of regional water authorities. (£10 million).

2. On the <u>pay</u> front the main groups, and a crude assessment of the likely cost are as follows:

(a) **Teachers.** 1989-90 settlement 6.3 per cent. May be able to hold 1990-91 settlement to inflation rate in Autumn 1989. Therefore likely to be 5-7 per cent.

(b) **Police.** Based on average earnings in the 12 month period to May. Likely to be about 9 per cent from 1 September 1989. Assume a similar increase 7-9 per cent from 1 September 1990.

(c) **Local authorities administration and clerical.** Asked for 12 per cent from 1 July 1989. Possible outcome 8 per cent. Hopefully lower (as inflation comes down) from 1 July 1990, say 5-6 per cent. Pressures to keep community charges down (ie lower LA spending) should help to reduce settlement.

(d) **Local authority manuals.** Likely to be a similar outcome to (c).

The size of the pay bill in 1988-89 for the four groups was £7.2 billion for teachers, £3.1 billion for the police, £6.2 billion for administration, and £3.2 billion for manuals. Assume these go up by the amounts indicated above in 1989-90. If we then assume spending in 1990-91 goes up in line with inflation at 5 per cent, the additional costs of the above scenario in 1990-91 would be about £150 million (teachers), £100 million (police), £100 million (administration) and £100 million (manuals), giving a total of about £500 million.

3. Taken together all these pressures could lead to additional spending of the following amount:

	£ million
Education	120
Transport	50
Law and Order	50
Personal Social Services	200
Other Environmental Services	200
pay	500
Total	1,120

4. Against this the Audit Commission has identified a number of potential savings in local authority current spending. In total they amount to about £2 billion; the main services affected are as follows:

				1990-91 Prices
(1)	Education in secondary schools - non teaching costs (productivity schemes for classes, etc).	£40 m	(1984)	£53 m
(2)	Savings on secondary school teachers	£160 m	(1986)	£197 m
(3)	Refuse collection methods	£134 m	(1984)	£180 m
(4)	Saving energy in local government buildings	£135 m	(1985)	£172 m
(5)	Reducing administration costs in council housing	£100 m	(1986)	£123 m
(6)	Further education value improvement opportunities	£40 m	(1985)	£51 m
(7)	Council house maintenance	£467 m	(1986)	£576 m
(8)	Cash flow management in local government	£100 m	(1986)	£123 m
(9)	Local authority roads (improvements in maintenance)	£60 m	(1986)	£74 m
(10)	Improving vehicle fleet management (pooling vehicles etc)	£86 m	(1984)	£116 m
(11)	Improving supply management	£150 m	(1984)	£202 m
(12)	Improving highways agency arrangements	£66 m	(1987)	£78 m
(13)	Improving highways maintenance (winter)	£15 m	(1988)	£16 m
		TOTAL		£1,961 million

5. Some of these savings will have been achieved already. Up to 1987-88 individual auditors identified savings of about £750 million and estimated that out of this total local authorities had achieved savings of £220 million. Assuming that the pace of improvement has accelerated further since 1987-88 it is possible that out of a total of available savings of £2 billion local authorities may have achieved savings of £1 billion. Thus further savings of up to £1 billion can still be achieved.

6. In addition we will be seeking to reduce the aggregate need to spend by £250 million as a result of the change to superannuation costs, from 1 April 1990 the inflation element of local authority pensions will no longer be paid from the collection fund. Instead they will be paid from the Pension Fund. As these funds are running surpluses local authority superannuation costs will be reduced.

7. Finally some of the changes to the Revenue Support Grant baseline should be reflected in reduced needs. The reductions amount to about £500 million and cover the Housing Revenue Account, Mandatory Student Awards etc.

ANNEX C

GRANT PERCENTAGES

Under the new local authority current financial regime there are three grant percentages that will be relevant:

(a) Aggregate Exchequer Finance (AEF) as a percentage of the aggregate need to spend;

(b) Total Government Support (including NNDR) to local authorities as a percentage of total local authority current spending;

(c) Total Government support (excluding NNDR) to local authorities as a percentage of total local authority current spending.

2. The grant percentage at (a) will be derivable from the figures announced in July. It is unlikely to change substantially between July and November. The aggregate need to spend could change at the margin, as a result of bilaterals in September/October, and hence the percentage could change slightly. This is the figure most closely analogous to the current grant percentage used by DOE (ie AEG as a percentage of relevant expenditure). But since AEF includes NNDR payments it is not directly comparable and both DOE and the local authority associations will claim that the NNDR payments are their own money.

3. For the same reasons DOE and the local authority associations will argue that (b) is misleading,. (b) will produce a high percentage, over 70 per cent in 1989-90, but DOE may resist attaching too much importance to the figure because of likely criticism from the local authorities themselves.

4. DOE will most likely want to focus on (c). They will have an objective in mind, probably something above 50 per cent. Neither (b) nor (c) can be derived in July at the time AEF is settled. DOE are however likely to try and anticipate what figure for (c) is implied by the grant settlement in July.

5. Historical figures for the various grant percentages are as follows:

	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90
AEF as a percentage of aggregate need to spend						
Government support (including NNDR) as a percentage of total local authority spending.				[Figures not yet available]		
Government support (excluding NNDR) as a percentage of total local authority spending						

ANNEX D

SAFETY NET

1. In the first year of the new system of local government finance, the Government is committed to operating a 'safety net' which will limit changes in the distribution of grant and non-domestic rate income between LAs. In broad terms, the safety net will ensure that the burden on domestic taxation (domestic rates and community charge) in any LA area is the same in real terms in 1990-91 as in 1989-90, assuming that the LA's spending also stays constant in real terms.

2. The purpose of the safety net is to prevent major changes in the distribution of grant and non-domestic rate income from disturbing LA finances in the first years of the new system. These changes are a consequence of moving from a system in which LAs are able to subsidise over-spending from the revenue paid by non-domestic ratepayers, and from a system in which the Government compensates LAs so that they only have to raise the same rate poundage for a given level of spending, despite variations in rateable values.

3. On current plans, the safety net will be phased out over the five years to 1994-95. By then, roughly £1 billion of grant and non-domestic rate income will have moved from LAs that are high spending or have low rateable values to LAs that are low spending or have high rateable values. In general, the losers from these distributional changes will be LAs in the North/Inner London, and the winners in the South/Outer London. It is currently planned that the safety net will be self-financing: as we hold up the losses for Inner London etc, so we will also delay the gains for Outer London and the South.

4. The safety net will have a major impact on the community charges actually levied in different areas gaining and losing from the new system in its first years. Some illustrative figures are set out below (these are based on LAs' 1988-89 budgeted expenditure which is the latest information readily available).

The table also shows the community charges that these authorities would have to levy if they spent at need under the new system, with the safety net in place (you will note that one of these figures is in fact negative).

	CC with safety net	CC without safety net	Payment into receipt from safety net	CCSN* +/- payment into or receipt from safety net
Inner London				
Camden	£438	£639	-£201	£49
Greenwich	£277	£589	-£312	-£62
Islington	£326	£480	-£154	£96
Lambeth	£277	£490	-£213	£37
The North				
Blackburn	£180	£251	-£ 71	£179
Barnsley	£189	£283	-£ 94	£156
Kirkles	£196	£289	-£ 93	£157
Rotherham	£215	£289	-£ 74	£176
Outer London				
Barnet	£305	£230	+£ 75	£325
Bromley	£222	£179	+£ 43	£293
Kingston	£267	£228	+£ 39	£289
Richmond	£325	£259	+£ 66	£316
The South				
South Bucks	£310	£235	+£ 75	£325
Cambridge	£288	£213	+£ 75	£325
Eastbourne	£268	£193	+£ 75	£325
Braintree	£263	£221	+£ 42	£292

*assumes CCSN of £250

5. There is a strong possibility that DOE (particularly Mr Gummer) will not want to see the gains that the new system of local government finance will eventually bring to Outer London and the South delayed by the safety net. (Under the safety net as announced there will be gains in 1990-91 for some authorities: those expected to benefit by more than £75 per community charge payer from the new system will gain so that only £75 of further gains are still to come. But all other gains will be phased in from 1991-92 at 25% a year, with the new system fully in place only in 1994-95. There will be small losses in 1990-91 for LAs losing under the new system to pay for the limited gains in that year; thereafter the losses will also be phased in at 25% a year).

6. DOE are, however, unlikely to want to finance quicker gains for Outer London, the South etc by quicker losses for Inner London and the North. They may press for the Exchequer to finance some or all of the gains, before the losses feed through.

7. It is difficult to estimate the danger that this issue will arise. There are also some important technical questions about how the Exchequer could finance gains for some authorities, but not others under the safety net. For obvious reasons, we have not yet discussed these with DOE officials.

8. The way in which we might handle pressure to put money into the safety net in this way would obviously need to be considered as and when it arose. But it may be that by satisfying some or all of DOE's concerns on this point - by using an addition to AEF to finance some gains for Outer London and the South - we could secure a better settlement overall.

9. There is one other point about the safety net which should be borne in mind. Because it will limit the burden of domestic taxation in any LA in 1990-91 to the same as in 1989-90 (for a given level of spending), it will also require us to provide a certain level of Government support - both for LAs individually and in aggregate. It would not be possible to keep the level of domestic taxation the same in real terms if we cut AEF significantly below its level in 1989-90 in real terms. DOE would then argue that such a cut would prevent us from meeting our commitments on the safety net.

10. This constraint is, however, not as restrictive as it may seem:

- First, given the other pressures on AEF this year it is unlikely that we will be pressing for a real terms cut in any case.

- Second, there is an issue as to what inflation indices should be used to calculate domestic taxation and LA spending in 1990-91 so that they are the same in real terms as in 1989-90. We are not committed on this point; and it may be to our advantage to argue for different inflation indices, as appropriate.

If (for the moment) we disregard the second point, then the safety net would seem to impose a floor on AEF of at least the notional total of AEF in 1989-90 (£21.6 billion) uprated by the GDP deflator, ie £22.5 billion.

ANNEX E

The aggregate need to spend (NTS) in 1990-91

Take total net GRE's for 1989-90		£27,662 million
Add specific grants within AEF		£ 2,849 million
Deduct adjustments to the baseline		
(i) Mandatory Student Awards	-£80 million	
(ii) Colleges	-£4 million	
(iii) Museums	-£3 million	
(iv) RFCs to HRA	-£348 million	
(v) CC preparation costs	-£55 million	
(vi) NNDR collection costs	-£34 million	
(vii) HB administration grant	+£19 million	
	-£505 million	
Total gross NTS in 1989-90	£30,006 million	
Increase for inflation 5 per cent	+£1,500 million	
Further upward pressure	+£1,000 million	
Scope for efficiency savings	-£500 million	
Reduced superannuation costs	-£250 million	
Total gross NTS in 1990-91	£31,750 million	

ANNEX F

1989 LOCAL AUTHORITY CURRENT SETTLEMENT: DATA UNDERLYING EXEMPLIFICATIONS: VERSION OF 27 APRIL

1. Need to Spend

Approach: take 1989-90 aggregate GRE; adjust for functional changes; add specific grants to get to gross needs.

	1989-90 £m
Aggregate GRE	27,662
plus HB administration grant	+ 19
less RFCs to HRA	- 348
Mandatory student awards (a)	- 80
ILEA museums	- 3
4 more polytechnics	- 4
CC preparation costs	- 55
Travellers' children (a)	- 8
NNDR collection costs	- 34
Lower superannuation contributions	- 250
Adjusted net needs	26,899
plus specific grants in AEF	2,849
Adjusted gross need to spend	29,748

(a) = provisional

2. Aggregate Exchequer Finance

(a) Revenue Support Grant

	1989-90 £m	
Rate support grant	9588	
plus positive adjustments		
- rate relief for EZs		+ 81
- rate rebates for disabled		+115
- reduction in HBA grant		+ 19
- universities rate (a)		0
Total positive adjustments		+215
less negative adjustments		
- abolition of LRT levy		-188
- 4 more polytechnics		- 4
- ILEA museums		- 3
- RFCs to HRA		-348
- mandatory student awards		- 80
- travellers' children		- 8
Total negative adjustments		-631
Adjusted RSG	9172	

(a) Not yet known

(b) Specific Grants

	1989-90 £m
In-service teacher training	119
Education support	81
Travellers' children	0
Careers service strengthening	18
Shetered employment	15
National Parks	9
Urban Programme (current element)	55
Housing Benefit Administration (adjusted)	91
AIDs and HIV (a)	7
Social Services training (a) (elderly and childcare)	14
Magistrates'courts (b)	179
Probation (b)	179
Police (b)	1952
Civil defence (b)	17
Commonwealth immigrants	113
TOTAL	2849

(a) Baseline will be 0, because agreed for one year only.

(b) Loan charge elements to be removed.

(c) NNDR

	£m	
	1989-90 (estimated outturn)	1990-91 (baseline, uprated by 2½ percent)
Total NNDR	9669	9911
of which		
- collection costs	34	35
- city offset	36	37
- distributable amount	9599	9839

(d) Total AEF

	£m	
	1989-90 (adjusted estimates)	1990-91 (baseline uprated by 2½%)
RSG	9172	9401
Specific grants	2849	2920
NNDR	9599	9839
AEF	21620	22160

3. CCSN Population

Assume 36 million community charge payers. (36.4 million adults at mid-1987, plus 600,000 assumed population growth, less 600,000 exempt, less 400,000 deduction for 500,000 students paying only one-fifth of the charge).

4. Budgets, 1989-90

DOE's latest estimate is £29,461 million, for budgeted total expenditure in 1989-90, ie gross of financing items but net of specific grants. This implies £32,310 m, including specific grants with AEF.

Adjustment apply as follows:

	1989-90
	£m
Net budgets	29461
less Mandatory student awards	-80
RFCs to HRA	-348
ILEA measures	-3
4 more polytechnics	-4
CC preparation costs	-55
Superannuation	-250
NNDR collection costs	-34
plus HB administration	+19
Adjusted net budgets	28706
Plus specific grants in AEF	+2849
Adjusted gross budgets	31555

L.A. CURRENT STRATEGY PAPERS.

FROM: A C S ALLAN
DATE: 2 May 1989

PS/CHIEF SECRETARY

cc PS/Paymaster General
Sir P Middleton
Mr Anson
Mr Monck
Mr Phillips
Mrs Case
Mr A J C Edwards
Mrs Lomax
Miss Peirson
Mr MacAuslan
Mr Potter
Mr Hudson
Mr G White
Mr Rutnam
Mrs Chaplin
Mr Call

LOCAL AUTHORITY CURRENT: TREASURY STRATEGY FOR E(LF)

The Chancellor has seen Mr Potter's note of 27 April to the Chief Secretary. He feels the Chief Secretary will need to be very tough in these negotiations. In this context, he was not much attracted to the fall-back on the safety net in paragraphs 39 and 40 (do not resist changes providing the cost can be contained within a given total for AEF).

2. He thought the Chief Secretary would also want to forge an alliance on as many issues as possible with Mr Ridley.

ACSA

A C S ALLAN

pmp

Ch/ You may wish to see attached DOE paper to PM ahead of No 10 mtg you attend on Thursday.

You will see that in setting 90/91 needs, CST proposes 3% real increase in 89/90 GREs and unchanged real AEF. This produces "challenging" (ie unrealistically low) CCSNs and significantly higher <u>actual</u> CCs.

Mr Ridley, on other hand, wants to base 90/91 needs on an uplift of 89/90 <u>budgets</u> and his AEF goes up 5% in real terms so as to produce a "realistic" CSN and actual CCs which are both lower and closer to CCSN.

You may wish to discuss with CST before Thursday.

[signature] DJS

CST [signature]

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[illegible]

FROM: BARRY H POTTER (LG1)
DATE: 19 May 1989
x4790

CHIEF SECRETARY

cc Chancellor
Mr Anson
Mr Phillips
Mr Monck
Mr Edwards
Mrs Lomax
Mr Hudson
Mrs Chaplin

[illegible]

LOCAL AUTHORITY CURRENT: PAPER FOR DISCUSSION WITH THE PRIME MINISTER

As agreed at the end of your meeting with the Secretary of State for the Environment and his Minister of State yesterday, Mr Osborn (DOE) prepared a revised draft of the paper for Thursday's discussion with the Prime Minister overnight. Mr Hudson and I discussed the revised draft with DOE officials this morning.

2. I attach a somewhat revised version of Mr Osborn's paper. Subject to comments from you, Mr Ridley and Mr Gummer, the paper will be sent to the Prime Minister on Monday evening.

3. Mr Osborn's draft was already much better than the DOE paper you discussed yesterday. We have sought however to make a number of changes: most of these were to reinforce the distinction between need to spend and actual spending on the one hand and the CCSN and actual community charges on the other. We have <u>not</u> sought to discourage DOE from presenting their options on need to spend on the basis of last year's budgets. In view of the Prime Minister's comments, there seemed no particular reason to dissuade DOE from this "own goal".

4. You will see that four options are displayed in the paper. The first two are your options as discussed with you yesterday evening; the other two are DOE's previous options, ie the low and basic options discussed in the first draft of their paper. I

POTTER TO CST 19 MAY

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should mention that DOE officials are somewhat sore at the early rejection of the high grant option which Mr Ridley conceded yesterday. Though there was no indication of it this morning, I would not rule out an attempt by DOE to reinsert that option in some form or other.

5. The presentation of the options follows our preferred model. It focuses attention on <u>spot</u> estimates for AEF, the CCSN and need to spend; and, separately, shows only <u>ranges</u> for actual spending and actual community charges. This is an important presentational step forward.

6. There is one point on which we are minded to concede if you are content. This concerns the range shown for projected actual spending. As I explained yesterday, our view is that DOE may well be about right to suggest that local authorities will raise their budgets by about 7% next year. However, we can argue, very plausibly, that they will spend less: DOE officials are just about prepared to accept, though reluctantly, that there may be something in our argument that last year's budgets were inflated by one-off items of expenditure financed by balances. However, they are insistent that our projection of actual spending - which forms the bottom of the range - ought to start on the basis of last year's budgets maintained in real terms <u>plus</u> £200 million for the extra costs of running the community charge system. I would be inclined to concede this point: it is an important presentational point with Mr Ridley, and adds realism to our projection at the cost of only £3 on a projected average community charge.

7. We will have the opportunity to comment on Monday and suggest any changes to the paper. (I did not have the chance to clear internally this morning the description of your options in the paper.) You may wish to discuss the draft paper with us: alternatively it would be very helpful if Miss Evans could pass back any comments to us early on Monday. Also senior officials here have not yet had a chance to view the paper and may also wish to suggest amendments.

Barry H. Potter

BARRY H POTTER

DRAFT MINUTE TO THE PRIME MINISTER

LOCAL AUTHORITY GRANT SETTLEMENT 1989

1. We are meeting for a preliminary discussion about prospects for the grant settlement on 25 May. It may be helpful to set out some initial figures and a range of options, which I have discussed with John Major.

2. The settlement this year will be particularly important and difficult. We must aim for sufficient grant and a pattern of distribution that will ensure that community charge levels in the first year can (or could be) set at reasonable levels. But we must recognise that some of the authorities may try to use the introduction of the new system as cover to push up spending levels and blame the resulting high community charge levels on the Government; this points to keeping grant levels down so as to discourage excessive spending.

[3. I am myself beginning to think that the only way to resolve this in the first year may be to set a realistic level of grant to enable authorities to keep average community charge levels down to a reasonable level if they budget sensibly, but to be ready to contemplate community charge capping for any authorities which abuse this by pushing up their spending excessively. I say this with reluctance because it will be controversial and ~~will~~ may be held to diminish local accountability. But I think it may be the only way to square the circle in the first year before chargepayers have become familiar with the new system, and are able to hold authorities properly to account for year on year changes in spending and charge levels.]

4. **The 1989 position.**

The following table summarises the position for 1989/90.

	1988/89 Outturn	1989/90 Settlement	1989/90 Budgets
Current Expenditure	£27,822m	£29,140m	£30,342m
% changes from 1988/89	-	4.7%	9.1%
AEG	£12,462m	£13,575m	£13,575m
% change from 1988/89	-	8.9%	8.9%

5. Provision for 1989/90 was 4.8% above 1988/89 budgets. This allowed for 4% general increase in expenditure plus an extra £110M for community charge preparation costs. In the event the increase in local authority expenditure was 9.1%, including £207m for community charge preparation costs. Local authorities drew down balances and kept domestic rate increases to an average 9.3%.

6. **The 1989 Round**

Moving forward to 1990/91 we have two main decisions to make at the aggregate level

(i) the total of need to spend
(ii) aggregate Exchequer finance for authorities (AEF) This is equal to needs grant (revenue support grant) + certain specific grants + non domestic rates.

7. The difference between those two figures will be the amount which authorities will have to raise from the community charge if they spend at need (the CCSN). We shall however also have to consider what will happen to the community charge if they spend above need by varying amounts. The table below

shows the CCSN over the last three years; we shall want a CCSN for 1990/91 which looks reasonable. I have also shown the average rate bill per adult; we shall want a likely average actual charge which does not seem unreasonable.

	1987/88	1988/89	1989/90 published	1989/90 adjusted*
CCSN	178	202	240	227
Average rate bill per adult (equivalent to the average actual CC)	224	246	274	258

which is rather clearer than the detail below.

8. The Table at Annex A summarises the key figures for illustrative options which officials have constructed as an initial sighting shot. (Fuller details are given in Annex A). John Major favours Option A; I favour Option D. The options produce the following results:

- In Option A the need to spend increases by 7.5% above this year's GRE (that is 3% above the current forecast of the GDP deflator). AEF goes up by 4%, so it is constant in real terms. This produces a CCSN of £264. Actual charges are in the range £300-321

- In Option B the need to spend increases by 9.5% above this year's GREs. AEF goes up by 6%. The CCSN rises to £270 but actual charges are somewhat lower at £289-£310.

- In Option C the need to spend is 3% above this year's budgets rather than GREs. AEF goes up by 6.5%. The CCSN is £273 and actual charges are £285-£306.

---

*Adjusted to allow for changes in function, eg ring-fencing of the housing revenue account.

- In Option D the need to spend increases by 4% over this year's budget, plus an additional £200m for the extra costs of collecting the community charge. AEF increases by 9.3%, giving lower actual charges of £270-£290. CCSN is £271.

Actual charges for all these options have been calculated on the basis of actual spending in the range £33.2 to £33.9 billion. This represents a cash increase of 4% to 7%, plus £200m for community charge collection costs, or around a real terms standstill to a real increase of 3%.

9. I suggest the important thing at our first meeting is to take a view on:

   i. What is an acceptable and plausible level for us to determine the need to spend in 1990/91 in relation to the provision or needs we set in 1989/90, the budgets that have come through for that year, the scope for efficiency savings and pressures for additional service provision, such as the need to provide for the administration of the community charge itself. I myself think this could hardly be set lower than 3% above this year's budgets in cash terms (the Option C figures) and would prefer to see it higher to ensure that a reasonable number of authorities can and will be below needs assessment.

   ii. What is the level of spending by local authorities that is actually likely to come through in 1990/91 bearing in mind changing service needs, inflation, possible economies, reactions to the first year of the community charge, and the impact on authorities of different possible grant levels. I do not myself believe it would be realistic to expect authorities to spend less than 7% above this year's budgets. (Their 1989/90 budgets are themselves 9% above 1988/89 budgets).

iii. What average levels of community charge we should be aiming at, both the standard level for spending at need, and the actual average charge that will emerge to finance actual levels of expenditure. I think that our most important objective should be to have a community charge for spending at need around £270. But we should have an eye to the likely average actual level of charges, which I think we should aim to keep below £300.

10. If we can take a view on acceptable levels for those three parameters the level of AEF needed to achieve the right results can then be calculated from them. I attach at Annex B a chart which may help to illustrate the different levels of AEF needed to achieve different levels of charge on various assumptions about the need to spend and the likely level of spend in practice. Of course, if the level of AEF which emerges from this process seems unreasonable, we will need to go back and reconsider our initial views on need to spend and charge levels.

11. John Major considers that it will be important to set challenging but realistic targets for local authorities on both needs to spend and the CCSN. These are the spending and community charge figures for which central government takes responsibility: in particular he suggests that the need to spend should be set at a level that reinforces the downward pressure on LA spending - which has grown faster than other public spending in recent years.

12. Accordingly he favours a need to spend total of a cash increase of 7.5% on the 1989-90 GREs (ie need to spend). This is a real increase of 3% on GREs which were themselves raised by 4% in real terms last year. This is sufficient to accommodate upward pressures on needs taking into account the scope for savings identified by the Audit Commission and savings from both the extension of competitive tendering and higher fees and charges. Under this option, AEF would be set

at £22.3bn, maintaining Exchequer support to local authorities constant in real terms. This would be consistent with a CCSN a little lower than the range I propose. The CCSN would represent a marginally lower burden on the chargepayer.

13. For illustration, John has also suggested an option with a higher need to spend and more Exchequer support ie option B. AEF increases by 2% in real terms and is only a little below my lower option on AEF. He is concerned that such a real increase in grant to local authorities would convey the wrong message about spending to local authorities. The need to spend under this option is set at £32.4bn, an increase of some 5% in real terms. He believes there must be dangers - bearing in mind the experience in Scotland - that such a level of need to spend will become a target for many previous low-spending authorities and lever up total spending accordingly. The CCSN consistent with this option is £270. With a higher need to spend, the CCSN must be raised to the range I propose, if the burden is not to fall wholly on the taxpayer.

14. <u>Other Issues</u>

The main other issues that will have to be settled in the round are:

i. the level and yield of the national non-domestic rate;

ii. the new needs assessments, which will affect the distribution of grant in the medium term;

iii. the details of the safety net which will be the key determinant of grant distribution in the first year.

15. Decisions on these will not be needed until September. However, we shall want to take a preliminary look at them in July, when I bring forward authority by authority exemplifications. We will want to be satisfied that the aggregates we settle on will give us an acceptable settlement whatever our final decisions in the Autumn on distributional issues.

Conclusion

16. The issue I think it would be most helpful to resolve at our meeting is whether the range of options shown in Annex A is the right range to put before colleagues in E(LF).

17. I am sending copies of this minute to Cecil Parkinson, John Major and Sir Robin Butler.

N RIDLEY

May 1989

A

OPTIONS.

Option A.

The need to spend figure has been derived by adding 7.5% to the need to spend figure for 1989/90.

AEF has been derived by adding 4% to the figure for 1989/90, ie a real terms standstill.

Option B.

The need to spend figure has been derived by adding 9.5% to the need to spend figure for 1989/90.

AEF has been derived by adding 6% to the figure for 1989/90.

Option C.

The need to spend figure has been derived by adding 3% to 1989/90 budgets.

AEF has been fixed so as to produce a CCSN of £273.

Option D.

The need to spend figure has been derived by adding 4% + £200 million to 1989/90 budgets.

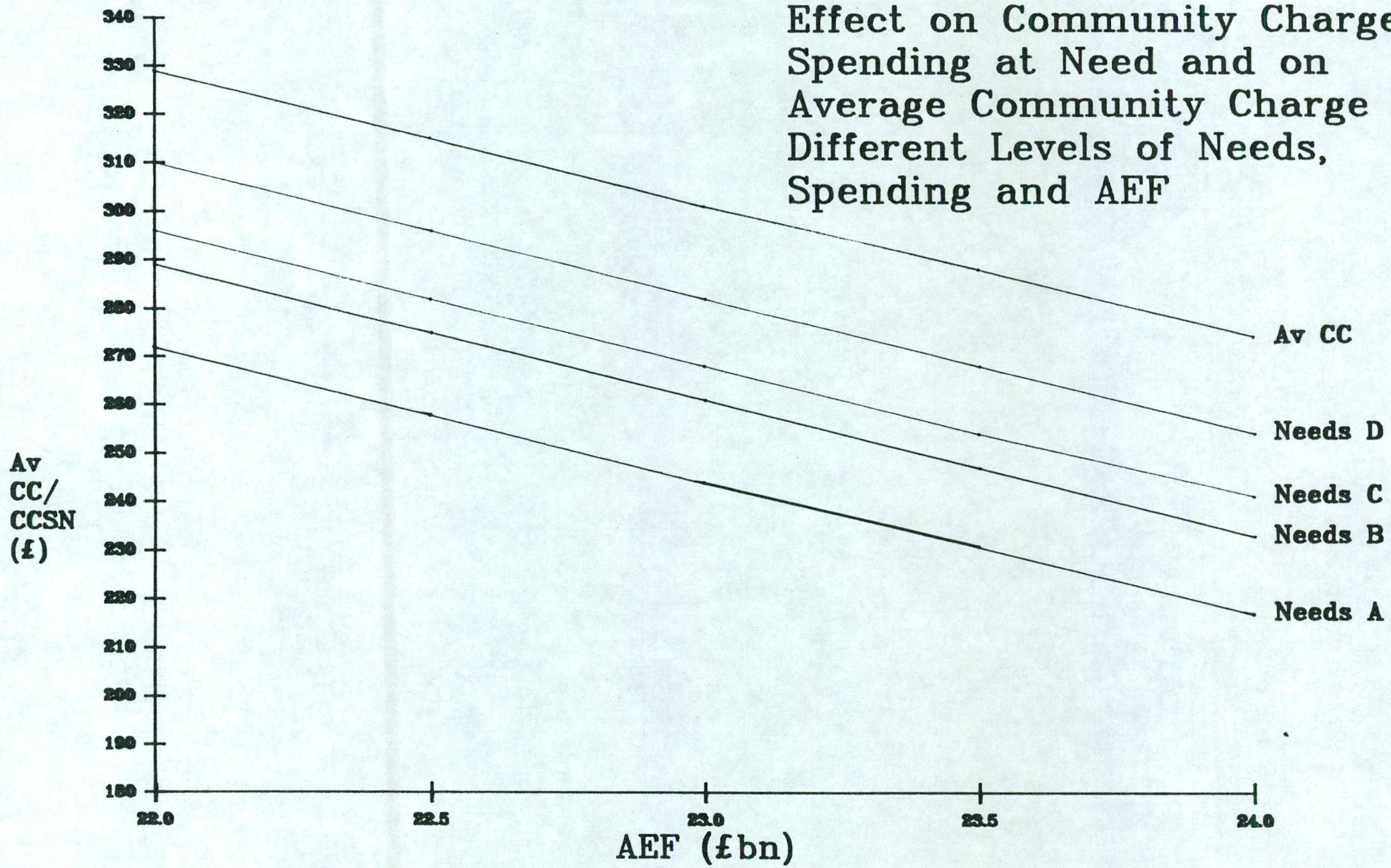
AEF has been fixed so as to produce a CCSN of £271.

AEF = needs grant + specific grants + Non-Domestic Rates.

LOCAL AUTHORITY CURRENT SETTLEMENT: POSSIBLE OPTIONS

OPTIONS		A	B	C £0.6bn	D £1.2bn
Need To Spend	£bn	31.8	32.4	32.7	33.2
AEF	£bn	22.3	22.7	22.8	23.4
Of Which Grants	£bn	11.8	12.2	12.3	12.9
Expenditure Falling On Chargepayers	£bn	9.5	9.7	9.8	9.8
CCSN	£	264	270	273	271
Range Of Likely Expenditure	£bn	33.2 - 33.9	33.2 - 33.9	33.2 - 33.9	33.2 - 33.9
Amount Falling on Chargepayers	£bn	10.8 - 11.6	10.4 - 11.2	10.3 - 11.0	9.7 - 10.4
Actual CCs	£	300 - 321	289 - 310	285 - 306	270 - 290
Memo Item:					
Increase in AEF	£bn	+0.9	+1.3	+1.4	+2.0

Effect on Community Charge for Spending at Need and on Average Community Charge of Different Levels of Needs, Spending and AEF



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cc Chancellor

CHIEF SECRETARY

REC. 22 MAY 1989

Mr Potter

Mr Phillips

Mr Edwards

Mr Hudson

Mr ~~CC~~ White

CABINET OFFICE

70 Whitehall London SW1A 2AS Telephone 01-270

P 03449

Ms Carys Evans
Private Secretary to the Chief Secretary
HM TREASURY
Parliament Street

22 May 1989

Dear Carys,

LOCAL GOVERNMENT FINANCE

I attach a copy of the note which I mentioned to the Chief Secretary on Thursday. It has been prepared in consultation with Barry Potter, to whom I am also sending a copy with thanks for his help.

Yours,

Richard

R T J WILSON

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LOCAL GOVERNMENT FINANCE: OLD AND NEW SYSTEMS

Government Decisions announced in July

Old System	New System
A. The July announcement used to cover provision for local authority current expenditure (which counted against the old Planning Total) and an estimate of financing items, as well as B and C below.	A. No equivalent announcement. The July announcement this year will cover only B, C and D below.
B. The total of grant-related expenditures (GREs).	B. The total of new needs assessments.
C. Aggregate Exchequer Grant (AEG), which comprised: i. Rate Support Grant; ii. specific and supplementary grants (both current and capital).	C. Aggregate Exchequer Finance (AEF), which will comprise: i. "needs" grant, formally known as Revenue Support Grant; ii. certain specific grants (current only); iii. national non-domestic rate (NNDR) income. AEF is the contribution to expenditure which will be determined and met by central Government and will count against the new Planning Total.
D. The difference between B and C determined the grant-related (rate) poundage for spending at GRE.	D. The difference between B and C will determine community charge for spending at need (CCSN). The Government has estimated publicly that this would have been £240 for 1989-90.
NOTE: C as a proportion of A was 43 per cent for 1989-90.	NOTE: C as a proportion of B may be around 70 per cent for 1990-91, depending on the decisions taken.

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Government Decisions announced in October

Old System	New System
E. An announcement used to be made in October about the distribution of Rate Support Grant to compensate for differences in needs and resources. This was paid to all authorities. Its level depended on F,G and H below.	E. In future there will be an October announcement about the distribution of needs grant to compensate for differences in needs only (not resources). It will be paid only to district authorities to cover the needs of all tiers. Its level will depend on F,G and H below.
F. The distribution of the GRE total between services.	F. The distribution of the needs assessment total between services.
G. The method of calculating GREs, which assessed the cost to each authority of providing a standard level of service.	G. The method of calculating needs assessments for individual authorities which will measure the cost of providing a standard level of service in the area.
H. Safety nets, which provided a mechanism to limit changes in grant each year.	H. The transitional safety net, which will provide a mechanism to smooth the transition to the new regime. There will be no power subsequently to limit changes between years.
	NOTE: A decision will also be needed on the amount of self-financed expenditure to be included within General Government Expenditure in the Autumn Statement.

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<u>Decisions by local authorities</u>

I. <u>Actual spending</u> by local authorities. Any overspend was a charge on the Reserve.	I. <u>Actual spending by</u> local authorities. This will count as General Government Expenditure (GGE): any excess over the Autumn Statement estimate will increase GGE.
J. The difference between I and E determined the <u>actual rate poundage</u> charged to domestic <u>and</u> business ratepayers in each area.	J. The difference between I and E will determine <u>actual community charges</u>. (The business rate contribution will be fixed under the NNDR: see C above.)

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SECRETARY OF STATE FOR THE ENVIRONMENT

CHIEF SECRETARY

REC. 23 MAY 1989

ACTION Mr Potter

COPIES TO CX, Mr Anson, Mr Monck, Mr Phillips, Mr Edwards, Mrs Lomax, Miss Peirson, Mr Hudson, Mr Call

PRIME MINISTER

22/5/89.

LOCAL AUTHORITY GRANT SETTLEMENT 1989

We are meeting for a preliminary discussion about prospects for the grant settlement on 25 May. It may be helpful to set out some initial figures and a range of options, which I have discussed with John Major.

The settlement this year will be particularly important and difficult. We must aim for sufficient grant and a pattern of distribution that will ensure that community charges in the first year can (or could be) set at reasonable levels. But we must recognise that some of the authorities may try to use the introduction of the new system as cover to push up spending levels and blame the resulting high community charge levels on the Government; this points to keeping grant levels down so as to discourage excessive spending.

I think myself that the right way to resolve this in the first year is to set a realistic level of grant which would enable sensible authorities to keep average community charges down to a reasonable level if they budget sensibly. It is essential that a number of the well run authorities should be able to achieve community charges at or below the national community charge for spending at need (CCSN). Otherwise our credibility will be lost. We always have the possibility of community charge capping for any authorities which abuse the position by pushing up their spending excessively. I say this with reluctance because it would be controversial and would diminish local accountability.

RIDLEY TO PM 22 MAY

The 1989 position.

The following table summarises the position for 1989/90.

	1988/89 Outturn	1989/90 Settlement	1989/90 Budgets
Current Expenditure	£27,822m	£29,140m	£30,342m
% changes from 1988/89	-	4.7%	9.1%
AEG	£12,462m	£13,575m	£13,575m
% change from 1988/89	-	8.9%	8.9%

Provision in the settlement for 1989/90 was 4.8% above 1988/89 budgets (and 4.7% above out-turn). This allowed for 4% general increase in expenditure plus an extra £110M for community charge preparation costs. At this level of spend, the settlement would have allowed rate rises to be kept to only 2%. In the event the increase in local authority expenditure was 9.1%, including £207m for community charge preparation costs. Local authorities drew down balances and kept domestic rate increases to an average 9.3%.

The 1989 Round

Moving to 1990/91 we have two main decisions to make at the aggregate level and announce in July

(i) the total of need to spend

(ii) aggregate Exchequer finance for authorities (AEF) This is equal to needs grant (revenue support grant) + certain specific grants + non domestic rates.

The difference between those two figures will be the amount which authorities will have to raise from the community charge if they spend at need. This amount divided by the number of chargepayers (estimated at 36 million) will determine the level of the community charge for spending at need (CCSN). This will also be announced in July and in effect the Government will take responsibility for it. The table below shows the CCSN over the last three years; we shall want a CCSN for 1990/91 which looks reasonable. We must also consider what will happen to the community charge if they spend above "need" by varying amounts. I have also shown the average rate bill per adult; we shall want a likely average actual charge which does not seem unreasonable.

	1987/88	1988/89	1989/90	
			Soon to be published	Adjusted for changes in function eg. ring fencing etc
CCSN	178	202	240	227
Average rate bill per adult (equivalent to the average actual CC)	224	246	274	258

The Table at Annex A summarises the key figures for illustrative options which officials have constructed as an initial sighting shot. (Fuller details are given in Annex A). John Major favours Option A; I favour Option D. The options produce the following results:

- In <u>Option A</u> the need to spend increases by 7.5% above this year's GRE (that is 3.5% above the current forecast of the GDP deflator). AEF goes up by 4%, so it is constant in real terms. This produces a CCSN of £264. Actual average charges are in the range £300-321

- In Option B the need to spend increases by 9.5% above this year's GREs. AEF goes up by 6%. The CCSN rises to £270 but actual average charges are somewhat lower at £289-£310.

- In Option C the need to spend is 3% above this year's budgets rather than GREs. AEF goes up by 6.5%. The CCSN is £273 and actual average charges are £285-£306.

- In Option D the need to spend increases by 4% over this year's budget, plus an additional £200m for the extra costs of collecting the community charge. AEF increases by 9.3%, giving lower actual average charges of £270-£290.

Actual charges for all these options have been calculated on the basis of actual spending in the range £33.2 to £33.9 billion. This represents a cash increase of 4% to 7%, plus £200m for community charge collection costs, or around a real terms standstill to a real increase of 3%.

I set out here my views on how we should assess the options. John Major's views are below. I suggest the important thing at our first meeting is to take a view on:

i. What is an acceptable and plausible level for us to determine the need to spend in 1990/91 in relation to the provision or needs we set in 1989/90, the budgets that have come through for that year, the scope for efficiency savings and pressures for additional service provision, such as the need to provide for the administration of the community charge itself. I myself think this could hardly be set lower than 3%

above this year's budgets in cash terms (the Option C figures) and would prefer to see it higher to ensure that a reasonable number of well-run authorities can and will be at or below needs assessment. This is the crucial test in my opinion on which the success of the whole system hangs.

ii. What is the level of spending by local authorities that is actually likely to come through in 1990/91 bearing in mind changing service needs, inflation, possible economies, reactions to the first year of the community charge, and the impact on authorities of different possible grant levels? However strong the pressures, I do not myself believe it would be realistic to expect authorities to spend less than 7% above this year's budgets. (Their 1989/90 budgets are themselves 9% above 1988/89 budgets).

iii. What average levels of community charge we should be aiming at, both the standard level for spending at need, and the actual average charge that will emerge to finance actual levels of expenditure. I think that our objective should be to have a community charge for spending at need around £270. But we should have an eye to the likely average actual level of charges, which I think we should aim to keep below £300.

If we can take a view on acceptable levels for those three parameters the level of AEF needed to achieve the right results can then be calculated from them. I attach at Annex B a chart which may help to illustrate the different levels of AEF needed to achieve different levels of charge on various assumptions about the need to spend and the likely level of spend in practice. Of course, if the level of AEF which emerges from this process seems unreasonable, we will need to go back and reconsider our initial views on need to spend and charge levels.

John Major considers that it will be important to set challenging but realistic targets for local authorities on both need to spend and the CCSN. These are the spending and community charge figures for which central government takes responsibility: in particular he suggests that the need to spend should be set at a level that reinforces the downward pressure on LA spending - which has grown faster than other public spending in recent years. John also suggests that grant is crucial, since the lower the level of grant, the lower the level of spending which is likely to occur within the range shown in the Annex.

Accordingly he favours a need to spend total of a cash increase of 7.5% on the 1989-90 GREs (ie need to spend). This is a real increase of 3.5% on GREs which were themselves raised by 4% in real terms last year. He believes that this is sufficient to accommodate upward pressures on needs taking into account the scope for savings identified by the Audit Commission and savings from both the extension of competitive tendering and higher fees and charges. Under this option, AEF would be set at £22.3bn, maintaining Exchequer support to local authorities constant in real terms. This would be consistent with a CCSN a little lower than the range I propose. The CCSN would represent a marginally lower burden on the chargepayer.

For illustration, John has also suggested an option with a higher need to spend and more Exchequer support ie option B. AEF increases by 2% in real terms and is only a little below my lower option on AEF. He is concerned that such a real increase in grant to local authorities would convey the wrong message about spending to local authorities. The need to spend under this option is set at £32.4bn, an increase of some 5% in real terms. He believes there must be dangers - bearing in mind the experience in Scotland - that such a level of need to spend will become a target for many previous low-spending authorities and lever up total spending accordingly. The CCSN consistent with this option is £270. With a higher need to spend, the CCSN must be raised to the range I propose, if the burden is not to fall wholly on the taxpayer.

Other Issues

The main other issues that will have to be settled in the round are:

i. the level and yield of the national non-domestic rate;

ii. the new needs assessments, which will affect the distribution of grant in the medium term;

iii. the details of the safety net which will be the key determinant of grant distribution in the first year.

Decisions on these will not be needed until September. However, we shall want to take a preliminary look at them in July, when I bring forward authority by authority exemplifications. We will want to be satisfied that the aggregates we settle on will give us an acceptable settlement whatever our final decisions in the Autumn on distributional issues.

Conclusion

The issue I think it would be most helpful to resolve at our meeting is whether the range of options shown in Annex A is the right range to put before colleagues in E(LF).

I am sending copies of this minute to Cecil Parkinson, John Major and Sir Robin Butler.

NR

NR
22 May 1989

OPTIONS

Option A

The need to spend figure has been derived by adding 7.5% to the need to spend figure for 1989/90.
AEF has been derived by adding 4% to the figure for 1989/90, ie a real terms standstill.

Opton B

The need to spend figure has been derived by adding 9.5% to the need to spend figure for 1989/90.
AEF has been derived by adding 6% to the figure for 1989/90.

Option C

The need to spend figure has been derived by adding 3% to 1989/90 budgets.
AEF has been fixed so as to produce a CCSN of £273.

Option D

The need to spend figure has been derived by adding 4% + £200 million to 1989/90 budgets.
AEF has been fixed so as to produce a CCSN of £271.

AEF = needs grant + specific grants + Non-Domestic Rates.

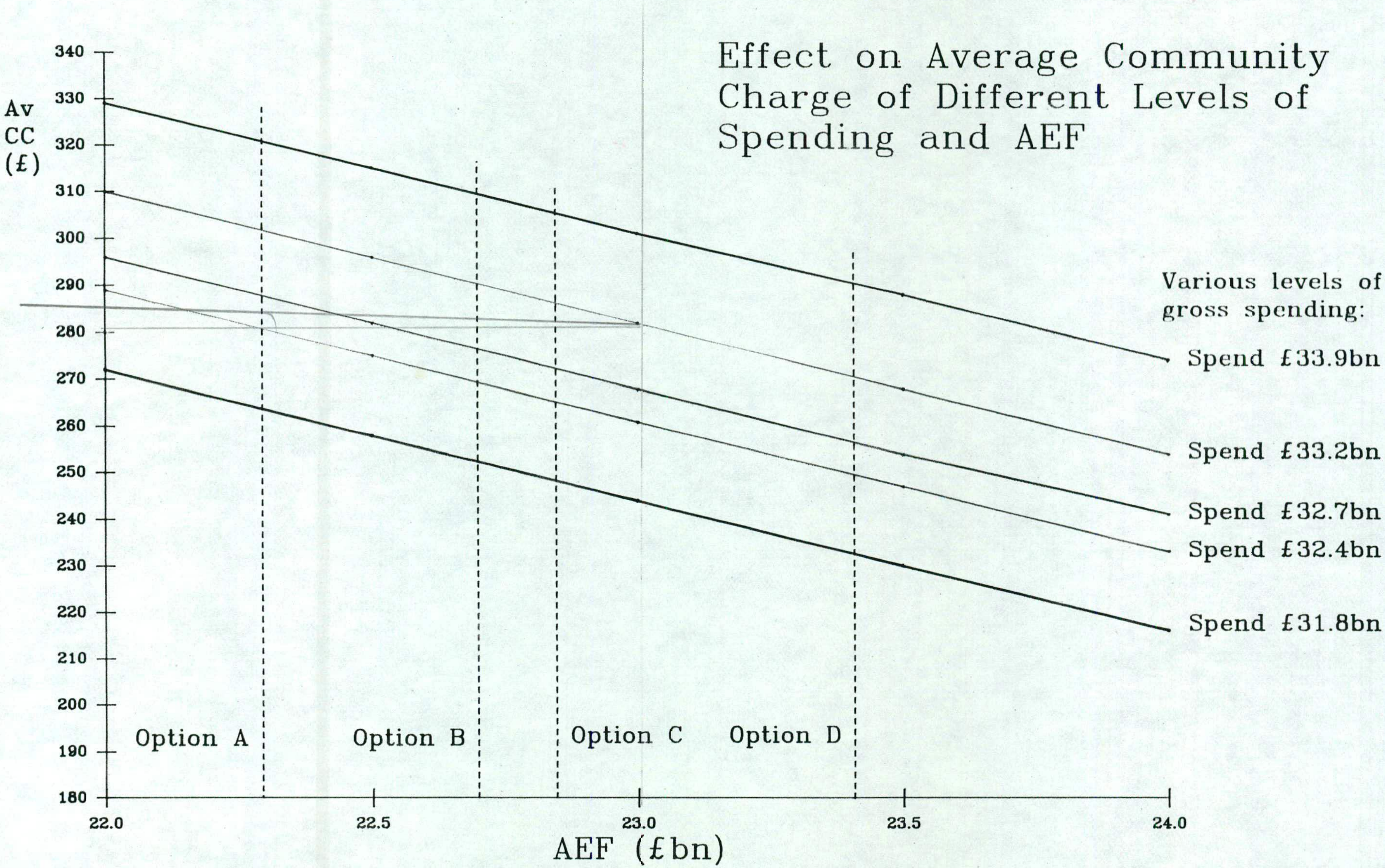
Key figures for 1989/90 are:	Need to spend (adjusted)	£29.6 billion
	AEF (adjusted)	£21.4 billion
	of which grants	£11.9 billion
	CCSN published	£240
	adjusted	£227
	Actual spend (adjusted)	£31.7 billion
	Average actual CC published	£274
	adjusted	£258

DC[illegible]28JA

LOCAL AUTHORITY CURRENT SETTLEMENT: POSSIBLE OPTIONS

OPTIONS		A	B	C	D
Need To Spend	£bn	31.8	32.4	32.7	33.2
AEF	£bn	22.3	22.7	22.8	23.4
Of Which Grants	£bn	11.8	12.2	12.3	12.9
Expenditure Falling On Chargepayers	£bn	9.5	9.7	9.8	9.8
CCSN	£	264	270	273	271
Range Of Likely Expenditure	£bn	33.2 - 33.9 33.2	33.2 - 33.9 33.5	33.2 - 33.9 33.7	33.2 - 33.9 33.9
Amount Falling on Chargepayers	£bn	10.8 - 11.6	10.4 - 11.2	10.3 - 11.0	9.7 - 10.4
Actual CCs	£	300 - 321	289 - 310	285 - 306	270 - 290
Memo Item:					
Increase in AEF	£bn	+0.9	+1.3	+1.4	+2.0

Effect on Average Community Charge of Different Levels of Spending and AEF



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FROM: BARRY H POTTER (LG1)
DATE: 24 May 1989
x4790

CHIEF SECRETARY

cc Chancellor
Sir P Middleton
Mr Anson
Mr Monck
Mr Phillips
Mr Edwards
Mrs Lomax
Mr MacAuslan
Mr Hudson
Mr Rutnam
Mrs Chaplin

JMP

LOCAL AUTHORITY CURRENT: MEETING WITH THE PRIME MINISTER, THURSDAY, 25 MAY

I attach briefing in note form as requested for tomorrow's meeting with the Prime Minister to discuss the local authority current settlement in England for 1990-91.

Briefing

2. The briefing is set out as follows: the various notes are in descending order of likely importance:

A - Speaking note.

B - AEF/grant.

C - Need to spend.

D - CCSN.

E Arguments for/against options.

F - Actual spending.

G - NNDR.

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H - Needs assessment/safety net.

I - Scope for savings.

J - Background data.

Objectives

3. As you know Mr Ridley believes the objective of the meeting should be to agree on the range of options to be presented to E(LF). Your aim should be to go further and to reach a close understanding on the key variable - the quantum of AEF. (Ideally, agreement on the need to spend and CCSN should be secured: but the precise accompanying presentation on need to spend and CCSN can be settled later if an agreement on AEF is possible.)

4. On the range of options, Mr Ridley has dropped his previous high grant option: it will be important to keep that out of consideration. Mr Ridley will however not give way on his target Option D if he can avoid it. And, only if he does give way, will you wish to move from Option A. Tactically it will be important for you to maintain Option A on the table while Option D remains.

5. On the quantum of AEF, Option A (£22.3 billion) is your target. But Mr Ridley's Option C (£22.8 billion) on AEF is your fallback (your own Option B (£22.7 billion) is a negotiating position).

6. In the event that agreement can be reached, then Option C would be a very good outcome. I understand that the Cabinet Office will be drawing the Prime Minister's attention to the Option B/Option C range as the likely area for any settlement. You may like to know that LG1's original expectation was for an outcome rather closer to Mr Ridley's target Option D (£23.4 billion), perhaps at AEF of around £23 billion.

Tactics

7. The speaking note at A also serves as a line to take for the meeting.

8. The greatest danger is that the Prime Minister will go for a lower CCSN than £265-£270. We have been seeking to influence both No.10 Policy Unit and Cabinet Office briefing to resist this: but whatever their line, the danger exists. In that eventuality you will have to move swiftly in order to point to the close link between need to spend and CCSN. Any move towards a CCSN at around £250, will mean that need to spend cannot be allowed to go above Option A on needs, even settling at your fallback position on grant. A simple ready-reckoner of AEF, need to spend and CCSN is included in Note E.

9. A second possible early diversion is the likely CCSN/actual CCs in individual authorities. DOE are in a position to give figures for Option D but not for Options A, B and C; even then their figures are on the basis of one interpretation of the safety net and new needs assessment - not cleared with us. It is best to stay off this ground. You can point to the fact that any DOE figures quoted have not been agreed with you and to the further scope for examining the distributional implications of other options. The CCSN for individual authorities will depend on decisions about needs assessments and the safety net which Ministers still have to take. And the actual CCs are up to authorities (see Note H).

10. If however the Prime Minister is content with a CCSN of around £265-£270 and the meeting can be kept away from distributional issues you will be able to focus the discussion on need to spend. This is Mr Ridley's weak ground: (I rather suspect the Cabinet Office are briefing in that vein.) The arguments against his proposals on need to spend, particularly in Option D, are set out at Note B.

Next Steps

11. Cabinet Office have certainly pointed to the possibility of agreement at around Options B/C. But the outcome is clearly uncertain. We suggest the follow-up strategy might be:

(i) if the meeting goes badly ie there is support for Option D or even something worse, it may be best to seek a second meeting with the Prime Minister before E(LF) after officials have done further work;

(ii) if the meeting reaches agreement on either a single AEF or suggests a narrower range, it will be necessary to think further how best to present the position at E(LF). Because of the long delay until the first E(LF) meeting, we are concerned that any understandings reached might be unstitched between now and then. We will therefore press for an earlier E(LF) discussion.

Barry H. Potter

BARRY H POTTER

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A

NOTE A

SPEAKING NOTE FOR MEETING

Recognise importance of this year's settlement - first under the community charge.

Agree with Nick that meeting should aim to [agree/narrow the range of options] on the three crucial variables - total AEF, need to spend and CCSN - for which central government is responsible.

AEF/grant is critical in determining what will happen. Agree with Nick's paragraph 2, "...keeping grant levels down so as to discourage excessive spending".

Need to strike a difficult balance therefore: settlement must enable smooth introduction of the CC but also maintain ten year policy of bringing LA spending under better control. Must not undermine fundamental aim of improving control over LA spending at the outset, with a grant settlement that generates a further surge in current expenditure.

Need enough grant to enable LAs to set reasonable CCs: too much will increase LA spending even further - and growth has averaged 3% real over the last three years.

Differences in view on precise gearing between higher grant and higher spending. But one message very clear: past attempts to smooth the way for new systems with more grant have led to higher spending. Targets were ended in 1986-87; grant was increased by 5% in real terms in 1987-88; real spending grew by 10% over these two years. Last year's generous grant settlement (up 9% in cash) led to a real rise in spending of around 4% - second largest annual rise in 10 years.

Need to spend is important too. The figure for which central government accepts responsibility. Important signalling role. Danger that too high a need to spend will lever up spending. Scottish evidence this year suggest need to spend figure seen as a minimum by many councils. Not surprisingly accountability has as yet had no impact on overspenders.

Right place to start is this year's GREs - themselves 4% up in real terms on 1988-89. Must balance rising demands for community charge implementation costs, education and other services against huge scope for efficiency savings identified by the Audit Commission. Nick's figures also strangely take no account of savings from his own policies next year - the wider scope for fees and charges and further competitive tendering.

My favoured option (A) offers a 3½% real increase in need to spend. (NB. using GDP deflator of 4% for 1990-91.) To go further would give quite the wrong signal: at this level of need to spend Conservative councils, on average, could raise their budgets by 4% in real terms and set CCs at the CCSN (adjusted for safety net).

<u>CCSN</u> must set a realistic and challenging target. Nick proposes £270. Agree this is the right order. Important that the figure is high enough to provide a reasonable contribution from chargepayers. But vital politically that substantial number of well-run councils should be able to show figures on the demand note at/below that CCSN.

Combining need to spend and CCSN in option A, indicates holding AEF constant in real terms. This is the right message: continuity of policy and downward pressure on LA spending, but realistic: will enable a wide range of authorities to charge CCSN if they budget sensibly.

Arithmetical relationship between AEF, need to spend and CCSN. But AEF vital because of the behavioural relationship between grant, actual spending and actual CCs.

Central government no longer responsible for projected <u>actual spending</u> and community charges, but clearly important. Should not base our assessment of likely outcome solely on last year's budgets; that would validate LAs overspend much of which was financed by unusually high drawings from balances. Many local authorities will budget cautiously next year starting from underlying spending levels, excluding use of balances. Actual spending should be no higher than budgets maintained broadly constant in real terms (ie £33.2b) - providing an over-generous grant settlement is avoided. (Excluding <u>all</u> balances this is equivalent to an 8% cash increase on 1989-90 budgets.)

Must recognise that <u>actual CCs</u> will vary widely: some Labour authorities will push up their spending and their community charges whatever we do - though as Nick points out we have our capping powers to take care of them. For our own supporters the option (A) I have proposed will allow them a real increase in spending <u>and</u> enable them to show that their CC (including the safety net adjustment) shown on the demand note at or below the CCSN.

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B

NOTE B

AEF/GRANT

- high grant levels lead to higher spending (acknowledged in last sentence of paragraph 2 of Mr Ridley's minute);

- grant as a percentage of LA expenditure has been falling for 10 years: no case for reversing that trend now;

- past experience indicates new LA finance systems cannot be bailed out by higher grant: ending targets in 1986-87 and higher grant in 1987-88 led to 10% real increase in spending over these 2 years; last year's generous 9% (cash) increase in grant led to 4% real increase in spending - second highest in last 10 years;

- under new system no financial disincentives to spending at the margin; accountability cannot have an immediate effect; so quantum of grant needs to encourage moderation on spending (a point registered by Mr Ridley last year);

- AEF scores directly in the new planning total; affordability; too high a settlement now will compress room for central programmes in the autumn;

- should negotiate on AEF and <u>avoid separate discussion of total grant (RSG + specific grants) and RSG</u>: if pressed, you can indicate that the total grant amount may be a little higher than DOE officials expect, because they have over-estimated NNDR; [WARNING: DOE have also underestimated specific grants so, on balance, their figures for RSG are probably about right.]

- extra RSG cannot be targeted under new system: so extra amounts benefit all authorities; no help for our supporters to reduce CCs, without helping the other two-thirds of all authorities - who will add it to spending.

NOTE C

C

NEED TO SPEND

1. Why Mr Ridley's proposals are excessive

- Option D represents a 12% cash increase on 1989-90 GREs (needs), up to 8% in real terms; the wrong signal: no case for a "break out";

- would be largest increase in need to spend ever in the last ten years: not justified by the fundamentals of demand pressures and costs and the scope for savings;

- would allow Conservative authorities on average to raise their spending by 8% in real terms and still charge the CCSN (+ safety net): hardly an inspiring start;

- great danger that whatever figure is set becomes a minimum - particularly with a term like need to spend.

2. Why Mr Ridley starts from the wrong base

- need to spend ought to be related to the old concept of GREs, not budgets;

- taking budgets validates overspending in 1989-90, which DOE paper identifies;

- must understand what that base represents: a 7% gap between 1989-90 GREs and 1989-90 budgets; but half of that gap financed by drawing down reserves/balances of £1 billion: tends to be one-off spending, at local authorities' own discretion: if built into the base for needs, adds to burden on taxpayer and chargepayer.

3. Why correct approach is GREs

- they represent need to spend, not a measure of what LAs choose to spend but what central government takes responsibility for in LAs spending;

- right that they should be based on last year's need to spend: Conservative authorities on average managed to stay within their GRE figures;

- excessive increase in need to spend would imply all Conservative authorities on average should raise spending in line with this;

- acknowledge case for need to spend as realistic but challenging target: agreed to one-off increase in GREs in 1989-90 (over 4%) to achieve that; no case now for a step increase, much larger than anything contemplated in the last decade;

- Option A represents a 7.5% increase in need to spend - around 3%-3½% in real terms (measured against current GDP deflator); this would be a large increase by historical standards and would mean nearly an 8% increase in need to spend over 2 years (1988-89 to 1990-91).

NOTE D

D

CCSN

- CCSN a central government responsibility: it must be realistic, achievable (for those which budget sensibly) and credible

- CCSN below £260 would not be credible or achievable even for our own supporters with an acceptable quantum of AEF: actual CCs in Scotland £281 in 1990-91 (= £295 maintained in real terms for 1989-90); published actual for England is £274;

- CCSN must be a figure which well-run LAs can be expected to deliver at £270, most Conservative authorities should be able to achieve that;

- CCSN closely linked to need to spend: cannot have figures for need to spend even as high as option A, unless CC is at or close to £270;

- CCSN figures shown in paper (p.3) need to be interpreted with care; show average rate bill per adult for spending at GRE not CCSN: (Government believes outcomes would have been different if CC policy had been in place); CCSN have risen so much in 3 years because

  (i) LAs overspend above provision; the overspend in one year, gets built into the base for the CCSN in the next;

(ii) GRE deliberately raised in real terms by 4% last year;

- comparison between adjusted £227 figure for 1989-90 and £270 for 1990-91 also irrelevant and invalid:

    i) irrelevant because the figure has not been published, only the £240 (and that has attracted no public attention); while the LAAs can work it out, they also understand its artificial nature;

    ii) invalid and artificial because it reflects changes in functions and higher than expected non-domestic rate income: Government would have taken different decisions with different functions and NNDR income in place.

- important thing is that CCSN is credible and valid for new system; comparisons with notional figures for earlier years irrelevant.

NOTE E

E

SUMMARY OF ARGUMENTS FOR AND AGAINST OPTIONS

1. This note summarises the likely arguments for and against the four options. "HMT" indicates Treasury arguments; "NR" indicates Mr Ridley's likely counter-arguments.

Option A

2. HMT arguments for:

- need to spend up 7½ per cent - significant real increase, allowing responsible councils to maintain services, while still spending at need, taking account of upward pressures on the one hand, and potential savings on the other;

- our own supporters spend slightly below need at present;

- AEF held constant in real terms.

3. NR arguments against:

- need to spend barely above last year's budgets in cash terms - very few authorities likely to be able to meet this;

- AEF up 4 per cent, but inflation bound to be higher (**HMT counter:** will review GDP deflator in due course: but a forward measure no reason to depart from projection at this stage;

- cash cut in RSG and total grant (RSG plus specific grants);

- average actual CCs above £300, even at bottom of range for likely spending;

- Option completely unrealistic, would be criticised even by our own supporters, and would discredit the whole policy.

Option B

4. HMT arguments for:

- need to spend up 9½ per cent on needs and significantly up on last year's budgets;

- and most of increase compared to Option A falls on the taxpayer - AEF goes up by 2 per cent in real terms, rather more than in the plans for public expenditure as a whole;

- [AEF actually almost the same as in NR' Option C];

- range of actual CCs straddles £300: on HMT spending forecast, most will be below £300; even on NR forecast, many will be, though some Labour authorities bound to be above, come what may.

5. NR arguments against likely to be modified version of those against Option A, especially:

- still unrealistically low need to spend;

- small real cut in grant.

Option C

6. NR arguments for:

- lowest realistic need to spend;

- shared burden between taxpayer and chargepayer, by building in significant increase in CCSN;

- certainly could not defend CCSN any higher than this.

7. HMT arguments against:

- wrong to base need to spend on this year's budgets - franks overspending;

- increase of over 10 per cent on this year's needs - will drag up spending in a large number of authorities;

- NB in Scotland, a number of authorities took the opportunity of the community charge to increase spending to need, but no sign yet of accountability pressures bringing overspenders back down to that level;

- compared to HMT Option B, both AEF and the CCSN have to be higher because of the high need to spend.

Option D

8. NR arguments for:

- need to spend must be realistic, so take last year's budgets, uprate for inflation, and add £200m for cost of collecting CC - only realistic way of getting to a need to spend which most authorities have a chance of meeting;

- significant real pressures on LAs - pay increases, new functions, uncertainty about CC;

- accept some of burden must fall on chargepayer, so substantial increase in CCSN - this too must be a figure which most LAs can reasonably expect to get close to;

- recognise substantial increase in AEF, but
  - important to get new system off to a good start;
  - half the increase in AEF is in the NNDR (**HMT counter:** estimate may be on the high side, and all in planning total anyway);
  - with uncertainty about yield of CC (defaults etc), LAs will be tempted to set high CCs to be on the safe side - all the more so if grant settlement appears mean;

- this is only option showing range of average actual CCs all below £300.

9. HMT arguments against:

- completely unaffordable;

- £2 billion on AEF, would pre-empt any room within difficult public expenditure round for priorities such as NHS, roads;

- basing need to spend on constant real budgets builds into the base every penny piece of overspending, and throws away ten years of efforts to bring LA spending under better control - CC is designed to help that, not to buy it out;

- extra grant would overwhelmingly lead to extra spending;

- package would send all the wrong signals to LAs: our own supporters might question the apparent message that they had been underspending, after all; Labour councils would have plenty of ideas for spending £2 billion, while still setting a high CC, and expecting the Government to be blamed.

READY RECKNONER FOR VALUES FOR CCSN (£)

NEED TO SPEND/ACTUAL SPENDING

AEF £bn	31.8	32.0	32.2	32.4	32.6	32.8	33.0	33.2	33.4	33.6	33.8	34.0
22.3	264	269	275	281	286	292	297	303	308	314	319	325
22.5	258	264	269	275	281	286	292	297	303	308	314	319
22.7	253	258	264	269	275	281	286	292	297	303	308	314
22.9	247	253	258	264	269	275	281	286	292	297	303	308
23.1	242	247	253	258	264	269	275	281	286	292	297	303
23.3	236	242	247	253	258	264	269	275	281	286	292	297
23.4	233	239	244	250	256	261	267	272	278	283	289	294

NOTE F

F

ACTUAL SPENDING

Factual

1. Local authority budgets (adjusted to cover same functions as in 1990-91) are £31.7 billion in 1989-90.

2. This includes nearly £1 billion of spending financed by balances and special funds.

3. HMT estimate that actual spending in 1990-91 will be £33.2 billion - an increase of 4 per cent on 1989-90 (GDP deflator) plus £200 million for the extra cost of running the community charge. (We tried to persuade DoE that this was not a functional change that should be recognised specifically, but they resisted strongly, and you agreed to show the higher figure in the paper for the Prime Minister. It is an important presentational point for Mr Ridley.)

4. DoE estimate that actual spending will be £33.9 billion - a real increase of 3 per cent, in line with the average of the past three years. But they have only just desisted from suggesting an even higher number, pointing out that the 7% cash increase assumed for next year is below this year's 9% cash increase.

Arguments for the Treasury estimate

5. The base

- DoE are assuming that all expenditure out of balances is built into the base for future years.

- In fact, much of it may have been of a one-off nature - procurement spending on school books, etc - rather than continuing current spending. That is a more appropriate use of balances. While the only evidence available on this is anecdotal (from the LAAs, Treasurers and councillors), it is supported by the manpower figures which have not grown. (75% of all LA current spending is wages and salaries; much of the remainder is procurement).

- Some LAs may have inflated spending through use of balances, in the hope of prompting the Government to frank this with higher grant. We have to call their bluff. [IF PRESSED: excessive budgets can be cut back through charge-capping.]

- DoE make no allowance for increased use of fees and charges, additional competitive tendering or efficiency savings, in the base. All mean that LAs can deliver same level of services for lower net spending. The Local Government and Housing Bill extends LAs power to levy fees and charges.

6. The real increase

- Not a uniform real increase, over the last three years: 1987-88 spending increased by step change in teachers' pay; 1988-89 broadly flat; 1989-90 reflected end of grant penalties, and burst of spending, much of it out of balances, in last year of the old system, before uncertainty of community charge.

- One way to encourage high spending would be an overgenerous grant settlement.

7. Implications for community charges

- Exemplifications assume all spending above AEF falls on community charge.

- Many LAs still have ample balances to draw on. If DoE insist on including all of spending from balances in the base, should assume some continuing use of balances to finance it.

- It may be argued that LAs will raise their CCs to meet higher spending <u>and</u> restore balances: (that is what seems to have happened in Scotland). However large balances still available in a substantial number of authorities. And the Government should not be setting grant so that LAs can in effect build up balances.

NOTE G

G

NNDR: DECISIONS AND TIMING

Background

1. There will be two sets of decisions for Ministers on the NNDR:

(a) in June final decisions on the transitional arrangements;

(b) in September/October, deciding the yield of NNDR and the starting poundage.

Transitional Arrangements

2. The main issue here is how to deal with gainers. Mr Ridley may want to drop the present proposal to limit gains to 10 per cent of the old rate bill, in real terms, so that gains would come through in full straight away. Protection for losers would be financed either by a premium on the poundage, or by the Exchequer (in effect, extra grant).

3. Mr Ridley is meeting his officials on Thursday afternoon (25 May), so is unlikely to raise this. If he does, you could say:

- will obviously consider proposals;
- but no case for Exchequer funding: always agreed transition self-financing.

Yield

4. The yield of the NNDR will be determined broadly as follows:

- 1989-90 yield from private sector and nationalised industries uprated by September RPI;

- plus Crown contribution in lieu of rates (revalued and uprated);

- plus allowance for buoyancy;

- less mandatory reliefs for charities, deduction for effect of appeals etc.

5. This is largely a matter of arithmetic, and setting the initial poundage follows from the decisions on the yield. Mr Ridley may argue, in the autumn, that the burden on business ratepayers is too high, and that the uprating should be rather less than the September RPI. But indications so far are that he is reasonably robust on this point.

6. All the options incorporate DOE's estimate of the NNDR yield, of £10.5 billion. We think this may be on the high side - it assumes a September RPI of 8 per cent, and buoyancy of 2 per cent. So you can resist arguments that RSG looks low on the grounds that

- what matters, to local authorities and for public expenditure, is the quantum of AEF;

- the NNDR estimate may be on the high side; but this is offset by a low estimate of specific grant, so that the RSG figure may be broadly right.

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NOTE H

DISTRIBUTION OF CCs: NEEDS ASSESSMENT AND SAFETY NET

Nicholas Ridley's paper flags up the issue of the pattern of CCs in England. The distribution of CCSN (any by extension actual CCs) amongst LAs depends upon their entitlement to RSG; this in turn depends upon:

A) the needs assessment

B) the safety net

H

In the long term the pattern of CCs depend upon the needs assessment. In the short term, it is determined mainly by the safety net (though need assessments still have some influence).

A. Needs assessments

DOE have been working on four basic options for need assessments. They have been shown to Mr Ridley and (belatedly) to us, though Mr Ridley has made no decisions as yet. The main points are as follows:

i) only one of the options would put more RSG in to the shires; it is not likely to be pursued;

ii) the DOE central (and most likely) option involves a shift of RSG resources away from shire areas and towards London;

iii) this option will help with the difficulties posed by the prospect of high community charge in London over the medium to longer term;

iv) but it does so only at the cost of raising community charges in the shires for a given level of spending;

v) this prospective diversion of RSG away from shire areas means that, even though Conservative authorities spend on average below GRE at present, they may find it more difficult to do so in future: Mr Ridley may argue that, unless there is a substantial increase in the aggregate need to spend, many Conservative authorities could face a real cut in their GRE, forcing them to cut real spending in order to charge the CCSN.

Line to take

- interesting figures; not yet seen by Treasury Ministers;

- understand only figures for needs assessment on Mr Ridley's high Option D available; that option not acceptable on wider grounds eg affordability

- understand importance of needs assessment; believe need to look at this on the basis of agreed/all the options for E(LF);

- in 1990-91 any deleterious effects will largely be overriden by the safety net; over longer term shire, areas - if they do lose out on grant - likely to moderate their spending in line with new needs assessment.

B. Safety net

Government has announced basic structure of safety net: it will:

i) keep burden of domestic taxation constant in any area in real terms for constant real level of spending in 1990-91 relative to 1989-90;

ii) but this is subject to a maximum contribution from any LA of £75 per chargepayer; (in practice, this would have meant an addition of around £5 to CCs for LAs which lose from the new system, and so element i) above is not delivered in full);

iii) phased out over four years; and

iv) self-financing.

Safety net has the following effects on starting CCs:

- reduces CCs in Labour controlled inner London boroughs;

- increases CCs in Conservative controlled inner London boroughs;

- increases CCs in the long-term gaining areas ie the South East and the South West;

- reduces the CCs in the North.

Options on safety net

However there is scope for interpretation and manipulation of i) and ii) above but we cannot lengthen the duration ie iii) or put in Exchequer funds iv).

DOE officials have exemplified one safety net so far. It is close to the announced scheme above. DOE have been able to bring the maximum contribution down to £50 per chargepayer; this concession is financed basically by assuming Mr Ridley's high grant option. (Under high grant, CCs are lower: the gap between 1989-90 rate bill per adult and the long-term CC is reduced: so is the need for safety net financing from the contributing authorities.)

The Prime Minister earlier supported the idea of a maximum CCSN in the first year of £350. This option not likely to be very attractive; it is in any case overtaken by consideration of a transitional specific grant for ILEA - which is <u>not</u> likely to be raised at the meeting.

For any level of RSG, main issues on the safety net likely to be on trade-off between:

- reducing the maximum contribution to £50 or below per chargepayer; this benefits some inner London authorities such as Westminster and Kensington and Chelsea, and winning areas in the South East; and

- adding to the initial CC elsewhere; the higher this cost, the more the losers start to suffer losses in first year eg in the North [and Stockport].

Line to take

If the safety net is raised on Thursday we suggest you:

- say it is too soon to look at distribution: your options have not been exemplified;

- agree more work should be done on alternative options; and

- reaffirm that the safety net must be self-financing. (Although any other form or longer duration of safety net would require new primarily legislation, we understand that Mr Gummer has floated that proposal within DOE.)

NOTE I

SCOPE FOR SAVINGS

AUDIT COMMISSION

Key points

1. Audit Commission reports identify potential savings of some £2 billion for local authorities as a whole.

2. By March 1988, auditors had identified annual savings of £750 million for individual LAs; authorities had actually achieved £220 million savings. More progress will have been made - but more savings identified, too.

3. So plenty of scope for further savings: not unrealistic to expect up to £500 million in total, in 1990-91.

Examples
(Figures are for total potential savings - some will already have been achieved.)

- £500 million a year on housing maintenance (report of November 1986)

- £100 million a year from better cash flow management (report of October 1986)

- £100 million a year from reducing administration costs in council housing (report of 1986)

- £30 million a year from competitive tendering for refuse collection (February 1987).

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Other potential savings

- Local Government and Housing Bill extends powers to set fees and charges for a wide range of services. Potential extra income of up to £50 million (HMT estimate)..

- Compulsory competitive tendering being extended to range of services: refuse collection; building cleaning; other cleaning; school meals, and other catering; ground maintenance; vehicle maintenance; and (shortly) management of sports facilities. DOE estimate savings building up to some £300 million, once programme is complete (starting August 1989, complete by January 1994).

NOTE J1

LOCAL AUTHORITY CURRENT SETTLEMENT 1989: FIGURES

	1989-90	OPTIONS A	B	C	D
NEED TO SPEND £bn	29.6	31.8	32.4	32.7	33.2
Increases on 1989-90					
- over GRE £bn		+2.2	+2.8	+3.1	+3.6
%		7.4%	9.5%	10.5%	12.2%
- over budgets £bn		+0.1	+0.7	+1.0	+1.5
%		0.3%	2.2%	3.2%	4.7%
AEF £bn	21.4	22.3	22.7	22.8	23.4
Increases on 1989-90					
- £bn		+0.9	+1.3	+1.4	+2.0
%		4.2%	6.1%	6.5%	9.3%
BREAKDOWN OF AEF					
- RSG £bn	9.2	9.0	9.4	9.5	10.1
- Specific grants £bn	2.7	2.8	2.8	2.8	2.8
- NNDR £bn	9.5	10.5	10.5	10.5	10.5
Increases on 1989-90					
RSG £bn		-0.2	+0.2	+0.3	+0.9
%		-2.2%	+2.2%	3.3%	10.2%
SGs £bn		+0.1	+0.1	+0.1	+0.1
%		4%	4%	4%	4%
NNDR £bn		+1.0	+1.0	+1.0	+1.0
%		10.5%	10.5%	10.5%	10.5%

J

	1989-90	A	B	C	D
Increases on baseline					
AEF £bn		+0.2	+0.6	+0.7	+1.3
RSG £bn		-0.4	-	+0.1	+0.7
Specific grants £bn		-0.1	-0.1	-0.1	-0.1
NNDR £bn		+0.7	+0.7	+0.7	+0.7
CCSN £		264	270	273	271
Increase on 1989-90 published figure (£240)		10.0%	12.5%	13.8%	12.9%
Increase on 1989-90 adjusted figure (£227)		16.3%	18.9%	20.3%	19.4%
GRANT PERCENTAGES					
AEF as % of needs	72.4%	70.1%	70.1%	69.9%	70.6%

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NOTE J2

HISTORICAL DATA FOR EXCHEQUER SUPPORT FOR LOCAL AUTHORITIES

1. You asked for figures for AEF, covering a run of years. This note also looks at other measures of Exchequer support.

AEF

2. Table 1 below shows figures for AEF for a run of years. It includes, for all years, those specific grants which will be within AEF for 1990-91. So specific grants which were within the old AEG, but are not within AEF, are excluded - the main examples are capital and loan charge grants, eg home improvement grants, and transport supplementary grant. The last column shows the 1989-90 figures adjusted for functional changes which will take place for 1990-91. (The figures for past years are outturn figures.)

Table 1: AEF, 1986-87 to 1989-90

£bn

	1986-87	1987-88	1988-89	1989-90	1989-90 (adjusted)
RSG	9.3	9.9	9.8	9.6	9.2
Specific grants	2.0	2.3	2.4	2.7	2.7
NNDR	7.7	8.2	8.8	9.7	9.5
AEF	18.9	20.3	21.0	22.0	21.4

AEG

3. These AEF figures are thus very much a construct. A better measure of the "generosity" of previous settlements may be the figures which were actually agreed each year, for Aggregate Exchequer Grant, and within that RSG. Table 2 shows these figures. These are settlement figures; the outturn figures are slightly different because of the effect of grant penalties.

Table 2: AEG, 1986-87 to 1989-90

£bn

	1986-87	1987-88	1988-89	1988-89 (adjusted for Polys)	1989-90
AEG	11.8	13.0	13.8	12.9	13.6
Increase on previous year	0	1.2	0.8	na	0.7
Of which, RSG	9.0	9.7	10.2	9.4	9.6
Increase on previous year		0.7	0.5	na	0.2

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OF 24 MAY

NOTE J3

LOCAL AUTHORITY SPENDING AND GRANT, 1981-82 TO 1989-90

	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1988-89 (ex Polys)	1989-90
GDP deflator	74.281	79.54	83.225	87.337	92.12	95.219	100	107.25	107.25	113.149
Relevant Expenditure (O)	19,933	21,765	23,005	23,900	24,039	26,370	28,704	30,877	30,242	33,114
Rel.Exp.(Real) m pnds	26,835	27,364	27,642	27,365	26,095	27,694	28,704	28,790	28,197	29,266
Real change %		1.97	1.02	-0.01	-4.64	6.13	3.65	0.3	n.a.	3.8
GGE(ex pp)(Real) bn pnds	162.9	167.3	170.1	174.9	174.6	177.3	177.0	173.5	173.5	176.4
Real change %		2.7	1.67	2.82	-0.17	1.55	-0.17	-1.98	-1.98	1.67
AEG(S) m pnds	10,900	11,500	11,800	11,900	11,800	11,800	13,000	13,775	12,940	13,575
AEG(S)(Real) m pnds	14,674	14,458	14,178	13,625	12,809	12,392	13,000	12,844	12,065	11,997
Real change %		-1.15	-1.94	-3.9	-5.99	-3.26	4.91	-1.2	n.a.	-0.5
AEG(O) m pnds	10,900	11,200	11,500	11,900	11,785	11,961	12,744	13,297		13,575
AEG(O)(Real) m pnds	14,674	14,081	13,818	13,625	12,793	12,562	12,744	12,398		11,997
GRE m pnds	17,194	18,358	19,156	20,003	21,237	22,952	24,237	26,015	25,180	27,662
GRE(Real) m pnds	23,147	23,080	23,017	22,903	23,054	24,104	24,237	24,256	23,478	24,447
Real change %		-0.3	-0.3	-0.5	0.7	4.6	0.6	0.0	n.a.	4.1
Grant percentage (S)	59.1	56.1	52.8	51.9	48.7	46.4	46.4	46.2	n.a.	43.3
Grant percentage (O)	54.9	51.7	49.8	50.0	49.0	45.4	44.4	42.8	41.2	n.a.

lg1.va/hudson/minutes/lac

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1. MR POTTER (LG1)

2. CHIEF SECRETARY

(Copies attached for:
Chancellor
Mr Anson)

FROM: A P HUDSON (LG1)
Date: 23 May 1989
Ext: 4945

cc: Mr Phillips
Mr Monck
Mr A J C Edwards
Mrs Lomax
Mrs Chaplin

Ch/ CST may wish to discuss at 10.45.

LOCAL AUTHORITY CURRENT: NOTE FOR MR PARKINSON

You thought it would be a good idea for you or the Chancellor to have a word with Mr Parkinson, in advance of the Prime Minister's meeting on Thursday (25 May), and to hand him a note setting out the Treasury case.

2. I attach a draft. The Cabinet Office will be briefing Mr Parkinson on the structure of the decisions to be taken, along the lines of the note for the Prime Minister cleared with Mr Potter. So the attached draft concentrates on the bull points of the Treasury's case. I am very sorry that work on the paper for the Prime Minister prevented me from letting you have it earlier.

APH

A P HUDSON

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KEY POINTS

LOCAL AUTHORITY GRANT SETTLEMENT 1989: KEY POINTS

Decisions to be taken

1. Under the new system of local authority finance, we have to decide three things:

(a) the need to spend, the amount local authorities, in aggregate, need to spend to provide a standard level of service;

(b) Aggregate Exchequer Finance (AEF), the total of Government support, comprising revenue support grant, certain specific grants, and non-domestic rates;

(c) the community charge for spending at need (CCSN), which is the difference between (a) and (b), divided by the number of chargepayers.

Obviously, we will also have regard to the actual community charges that are likely to emerge. But it is a key part of the new system that local authorities, not Ministers, set the actual community charge, and are accountable to the voters for it. And as Nicholas Ridley's paper says, some authorities will set high charges whatever we do - any extra grant will lead to higher spending, not lower charges.

2. So our <u>objectives</u> should be:

(a) a fair settlement, in which the need to spend and the CCSN are challenging but realistic targets for reasonable local authorities, including, of course, the vast majority of our own supporters;

(b) continued pressure on overspending councils to get their spending under control - the whole aim of the community charge policy;

(c) a settlement which can be met within our overall objectives for public expenditure in what is likely to be a difficult round.

In short, a settlement which is <u>fair, consistent, and affordable</u>.

3. There are some points to which the Treasury attaches particular importance.

- For ten years, as a Government, we have been trying to bring local authority spending under better control. The community charge is the culmination of that.
- Extra grant tends to feed through into extra spending, rather than lower community charges. Nicholas Ridley implicitly accepted this last year, in agreeing that the end of grant penalties meant a lower settlement was called for.

Even so, spending has increased significantly, and the Prime Minister suggested that the settlement may have been overgenerous.

- The need to spend and CCSN - the benchmarks for accountability - must be realistic but challenging targets. Our own supporters, on average, are spending a little below the need to spend this year. So there is no case for a step increase.
- Basing the need to spend on this year's budgets, rather than this year's need to spend, would frank overspending.
- A high need to spend has dangers. In Scotland, some traditionally moderate spenders took the opportunity of the community charge to increase spending up to need. But accountability has yet to bring the overspenders down to that level.
- We cannot control actual community charges. They will vary considerably. But the range for Option B, at least, suggests that most moderate overspenders could be below £300, though some Labour authorities are bound to go higher, whatever we do.

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CHIEF SECRETARY

FROM: B H POTTER
x4790
Date: 25 May 1989

cc: Chancellor
Sir Peter Middleton
Mr Anson
Mr Phillips
Mr Monck
Mrs Lomax
Mr Edwards
Mr Hudson
Mrs Chaplin

LOCAL AUTHORITY CURRENT: FOLLOW UP TO MEETING WITH THE PRIME MINISTER

I had a telephone call this afternoon from Mr Roberts (DOE). The Secretary of State for Environment held a debriefing meeting following this morning's discussion with the Prime Minister. You will be interested to know the way Mr Ridley's thinking is going.

2. He has instructed his officials to prepare a letter over the next week for him to send to you on June 5th, copied to the others who attended today's meeting. The letter will set out exemplifications for individual authorities for Options B and C. In order to do that officials will have to make assumptions about the new needs assessments and the safety net. I have asked that we should be consulted on the particular form of the safety net and needs assessment incorporated in the exemplifications.

3. It is the underlying purpose of this letter which is significant. Mr Roberts made it quite clear that Mr Ridley, sensing that matters have not gone well so far, is interested in securing a firm deal with you in advance of E(LF). He will argue that you would do better if you make such a deal now than risk the discussion going to E(LF).

4. Mr Roberts indicated that the proposed deal would be around Option C, I suspect Mr Ridley may have ambitions for just a little more on AEF. But until DOE have done further work, they are not in a position to offer any figures. We will press them to let us know as soon as possible what option they have in mind.

5. Until we see the numbers, it would of course be premature to reach a view. But a deal now at or very close to Option C, providing it can be suitably presented in terms of need to spend and CCSN numbers, is an attractive prospect.

V. Abrahall

pp BARRY H POTTER

FROM: J M G TAYLOR
DATE: 31 May 1989

PS/CHIEF SECRETARY

cc Sir P Middleton
Mr Anson
Mr Phillips
Mr Monck
Mrs Lomax
Mr A J C Edwards
Mr B H Potter
Mr A Hudson
Mrs Chaplin

LOCAL AUTHORITY CURRENT: FOLLOW-UP TO MEETING WITH THE PRIME MINISTER

The Chancellor has seen Mr Potter's note of 25 May. He has commented that this is encouraging.

J M G TAYLOR