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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

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## CASH LIMITS AND THE RATE SUPPORT GRANT

Memorandum by the Chief Secretary to the Treasury

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On 20 September, the Committee endorsed the main lines of the approach for setting cash limits in 1980/81 in E(79)34 but asked for further consideration of the arrangements for the Rate Support Grant cash limit.

2. The Committee were concerned to strike the right balance between fairness as between local authorities and applying an effective financial discipline, particularly on pay negotiations.

3. The attached note by my officials has been prepared in consultation with other departments concerned in the light of our conclusions.

### The Options

4. Main options discussed in the note are:

(i) cash limits on the expenditure of individual local authorities (paras 5-11)



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(ii) a sliding scale arrangement so that the proportion of expenditure to be financed by grant will be influenced by local authority pay or rate increases after November (paras 12-20)

(iii) a single cash limit set in November and adhered to (paras 21-24).

5. My own view, subject to the judgement of colleagues, is that a single cash limit may offer the best discipline, provided that we make it absolutely clear that we shall stick to it.

Cash limits on Individual Local Authorities

6. Cash limits imposed on the total expenditure of individual authorities could be used to apply pressure on pay, rates and expenditure at local and national level, all at the same time. But such a power would require urgent legislation, which could hardly be enacted before the November RSG settlement. It would be bitterly opposed by the local authorities as an assault on the present degree of local government independence. A substantial addition of well qualified central government staff would be required. Enforcement would risk "Clay Cross" confrontations, followed by replacement of local authority elected representatives by Statutory Commissions and the continuing exercise of direct and detailed central government financial control of significant numbers of local authorities.

7. This course does not look practicable. So we must operate through the existing RSG machinery. The aim should to to encourage the majority of authorities to cooperate with the Government's objectives, and to discourage use of their independent rating powers to finance unacceptably higher levels of expenditure and pay.







A Sliding scale cash limit

8. A sliding scale related to pay might increase our influence on local authority negotiators. But any scale is normative and in my view would imply too close a Government involvement with the outcome of individual pay negotiations. Furthermore, if authorities expect settlements to turn out on the high side, the threat of loss of grant may encourage them to rate higher than otherwise. A sliding scale related by rates, by bearing more directly on the total finance available to local authorities, would discourage excessive pay settlements and make it more likely that any such settlements would have to be financed at least in part through reductions in services. But it would require legislation to enable the Government to discriminate between authorities on the basis of their rate increases, and such discrimination would not operate fairly, as we recognised at our last meeting.

A Single Cash Limit

9. If it is felt that any sliding scale arrangements should be ruled out we are left with a single cash limit set in November and adhered to. This has the advantage of being clear and certain. After the actions we have taken this year, local authorities will not underestimate our determination to make the cash limits discipline effective. If the Secretary of State for the Environment's proposals on unitary grant (which are to be discussed shortly in H Committee) are agreed, the transitional arrangements envisaged for next year for discriminating against high spending authorities will help to reinforce the cooperation of the majority. If colleagues responsible for local authority expenditure consider that this option would be preferable and would provide the best prospect of effective financial discipline over the majority of local authorities I would be content to adopt it.

HM Treasury
28 September 1979

(J.W.B)

CASH LIMITS AND THE RATE SUPPORT GRANT (RSG)
Note by Officials

Ministers have asked officials to consider ways in which the RSG cash limit might exert an effective discipline over pay negotiations while working fairly as between local authorities.

2. The major local authority settlements are negotiated across-the-board. The Local Authority Conditions of Service Advisory Bureau, (LACSAB) plays a decisive role. LACSAB has generally refused to make pay offers in excess of the allowance in the RSG cash limit without an undertaking by Government that grant support will be forthcoming. Thus it has been clearly influenced by the cash limit.

3. The main local authority pay settlements are the manuals, (settlement date 1 November), the teachers (1 April) and the white collar grades (1 July). The manuals negotiation is crucial coming as it usually does after the cash limit has been set in November but before rates have been fixed in about March. Local authorities obviously take it as a guide to whether the cash limit is likely to be sufficient.

4. This note describes three possible options:

(i) Cash limits on individual local authorities
(ii) Cash limits set on a sliding scale
(iii) A single cash limit.

Option (i) : cash limits on individual authorities

5. A limit might be placed on the expenditure which individual authorities incur in providing services and making good deficiencies in their balances, with allowance for increases in pay and prices. This would automatically control not only total expenditure at national and local level, but also rate increases, since grant - the other main source of income - is centrally determined.

6. Individual cash limits would apply indirect pressure to national wage negotiations because settlements in excess of the pay increase provision could only be met from volume reductions.

7. But such a system would raise an important constitutional issue about the balance of responsibility between central and local government. It would be argued that it would destroy local democracy. Confrontations of the kind that emerged at Clay Cross over rent policy would almost certainly occur.

8. The difficulties arise partly from problems of setting realistic individual cash limits, partly from problems of enforcement.

9. Government does not have information to calculate individual cash limits in a way which takes sufficiently precise account of legitimate variations in local circumstances. But tight cash limits, which are essential to achieve the overall objective of maximum influence on pay settlements, could bite so hard on many authorities that they might not be able to discharge their statutory duties without ~~broadening~~ breaching the limits. Furthermore, some authorities would deliberately set out to challenge Government policy.

10. These considerations suggest that an individual cash limits system would require (i) monthly central government monitoring of the financial performance of each local authority; (ii) readiness to increase individual cash limits where an authority can prove that it cannot discharge its statutory duties; (iii) sanctions to prevent or penalise local authority elected members who deliberately set out to breach the cash limits, eg statutory commissions.

11. Legislation would be necessary and substantial additional well qualified central government staff.

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Option (ii) : Cash limits set on a sliding scale

12. A sliding scale arrangement for the RSG cash limit would enable the Government to relate the proportion of expenditure met by grant to decisions on pay or rates taken by local authorities, with a view to exerting greater leverage over them.

Sliding scale related to pay

13. With a sliding scale related to pay, while the other elements of local authority costs would be covered by a fixed cash limit, the Government would set out what proportion of pay increases it was prepared to bear through RSG; the higher the pay increase the lower the proportion. The remainder would have to come from the authorities' rates and balances, or from cutting expenditure.

14. It would be for consideration whether a final cash limit should be declared in March, on the basis of settlements made up to then (effectively only the manuals and related groups) or whether the grant contributions should be adjusted for each settlement as it was made.

15. Such a sliding scale related to pay would exert influence over local authority negotiators. But it would not avoid a Government judgement about an acceptable level of pay increases, which would be equated by negotiators with the level of settlement qualifying for the full Government share. The scale might be constructed so that it began to exert pressure before the wage settlement level assumed in the pay forecast was reached; but this would involve an additional squeeze on volume. At the same time high pay settlements would still receive some grant support. The existence of the scale would imply a degree of Government involvement with individual local authority pay negotiations which would be inconsistent with its general posture.

16. If pay settlements turned out on the high side, it would remain open to individual authorities to circumvent the cash limit discipline and preserve volume or jobs by raising rates rather than making economies. There would also be inequity

between local authorities, in that those which did make savings to offset the cost of pay awards would get less grant along with those which maintain their expenditure.

A sliding scale related to rates

17. This would relate grant payments inversely to rate increases above a certain level. Under this scheme the final cash limit would be fixed as soon as rate increases were known.

18. This approach would bear directly on the total finance available to local authorities and, by restricting the scope for using rates to increase this total, would also exert pressure on pay negotiations. But because rates are determined separately, a sliding scale based on average rate increases, could have a perverse effect on the rating decisions of individual local authorities if they expect the average to turn out high. To counter this, steps would have to be taken to ensure that individual authorities willing to comply with Government objectives did not suffer grant reductions because of the decisions of other authorities.

19. Discriminating between authorities on the basis of rate increases would require legislation. There would be substantial problems of equity. For an individual authority, the size of the rate increase in any one year may be governed by its budgeting in the previous year as well as by expenditure in the current year. Authorities that followed Government guidelines on inflation last year may have rated at a level that was too low to meet the continuing cost of their services. Conversely, authorities that rated for a relatively large income last year may be able to keep their rates within any given threshold this year and still maintain high levels of expenditure.

20. There is also a general objection to sliding scale arrangements. Changes in the total of RSG affect the distribution of grant differentially. Without a pre-determined total there would be no basis for discussing the effects of the November settlement in relation to particular authorities or groups of authorities, eg the shire counties. Furthermore individual authorities would be unable to make firm forecasts, in



advance of setting their rates, of the amount of grant they would receive. This uncertainty would encourage over-insurance in the form of higher rates.

Option (iii) - A single cash limit

21. As in the past, the Government would announce, at the same time as the RSG settlement in November, a firm cash limit covering the maximum total amount of grant it was prepared to make for the year ahead. The RSG settlement itself would allow for the planned levels of expenditure at November 1979 prices. The allowance to be made for pay and price increases after November 1979 would be decided shortly before announcement of the cash limit in accordance with the procedures agreed by E Committee. As with other cash limits it would not be possible to conceal the underlying assumptions entirely, but the Government could say that the calculation allowed for a range of possible outcomes.

22. This approach would make the limits to Government support clear at the outset and could be expected to influence the important manuals settlement due in November. Each local authority would be able to assess its likely share of grant with some precision and this would help to reduce the amount of uncertainty it faced when deciding its rates.

23. This approach does not directly discourage local authorities from raising the rates unacceptably to finance an excessive settlement on the manuals or higher expenditure generally. On the other hand local authorities will know that they will have to bear the entire cost of any excess expenditure on the rates. They will also know from experience this year that the Government can take ad hoc penal measures to reduce grant if they think the situation so requires.

24. The general discipline will be reinforced if the Secretary of State for the Environment's proposals on unitary grant are agreed. The transitional arrangements envisaged for next year for discriminating against the highest spending authorities should help to secure the cooperation of the majority of authorities. Moreover if it did prove necessary to make any ad hoc general adjustment of grant like this year's, they would enable it to be done on a more discriminating basis. These powers are explained in more detail in the Annex.

ANNEX

## UNITARY GRANT

Note by the Department of the Environment

1. Unitary grant operates by reducing the rate of grant support to marginal expenditure above a certain limit, set in relation to a central government assessment of the authority's expenditure need.

2. In essence the arrangement would work by first identifying a group of profligate authorities, whose expenditure was substantially in excess of their centrally assessed expenditure need, and then tapering their grant rate so that the more they planned to spend in excess of assessed need, the smaller the proportion of each additional tranche of expenditure that would be met from central government funds. To the extent that this financial pressure succeeded in holding down the expenditure of such authorities, it would also help to keep down their rates.

3. DOE at present envisaged that the unitary grant, and the transitional arrangements for 1980/81 which would follow similar principles, would be used solely to apply pressure to a relatively small group - say about 20 - of high spending authorities. They would therefore not be appropriate for applying the sort of across-the-board pressures on rates and expenditure that would be required to influence national pay negotiations. But the knowledge that the well-known high spenders would have a strong incentive to keep their rates down could well help to create a more restrined climate among other authorities who might otherwise feel that, whatever their budgeting policy, their performance would seem reasonable when judged against the extremes.

4. The unitary grant arrangements <u>could</u> be used to apply pressure to a much larger number of authorities by lowering the threshold used in defining overspenders so that any authority spending more than its assessment of expenditure need was included. But the current assessments of need are based on generalised statistics, so are too broad brush to apply with justice to authorities whose spending is close to assessed needs. Furthermore, the present basis of needs assessment, which will have to be used in the initial transitional year, is widely regarded as unsatisfactory.