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CONFIDENTIAL

PRIME MINISTER

Rate Support Grant
(C(79) 47)

BACKGROUND

This is the last year of the present Rate Support Grant system. The new Unitary Grant (which H Committee will formally ratify on Wednesday) will come into operation from 1981-82 onwards. Transitional arrangements will operate at the end of 1980-81.

2. Cabinet approved in the summer the volume of local authority expenditure for 1980-81. E Committee approved in October (E(79) 10th Meeting, Item 1) after two false starts, the general approach to pay and cash limits, including the Rate Support Grant.

3. There are now three main objectives:-

(i) To hold the level of rates at a reasonable level, and if possible to reduce the level of local authority expenditure.

(ii) To put some pressure on public sector pay.

(iii) But, despite this, to avoid the breakdown of the system or any confrontation with the authorities/unions.

4. The timetable is tight. The RSG percentage for Scotland has to be announced on 16th November and that for England and Wales on 20th November. It is the Chancellor's present intention to announce cash limits for the nationalised industries on 20th November as well.

5. You established MISC 21 under the Home Secretary's chairmanship to process the RSG for next year. This paper is his report. The key to the paper is in Annex D, which shows, for various combinations of inflation assumption and of RSG percentage, the total volume of Rate Support Grant for the year, and the likely effect on rate demands. All this is on the assumption of a constant distribution formula (the Group has not been able to find anything better). Various other related proposals are set out clearly in the paper, but do not need discussion.

HANDLING

6. You should ask the Home Secretary to introduce his paper. You might then call in turn on the Secretary of State for the Environment and the Chief Secretary (or the Chancellor, if he wishes to speak instead). You might then call for general comments from three Ministers not involved: the Secretaries of State for Employment, Industry and Trade. Then you might go back to the main actors: the Secretaries of State for Scotland (who has his own separate RSG to follow the pattern established by Cabinet) and Wales (who is directly affected by these proposals); and the Secretaries of State for Education and for Social Services and the Minister of Transport, all of whom have an interest in the end product. (The Transport Supplementary Grant itself is not affected by these proposals and is the subject of separate correspondence).

7. The end-product of the discussion will be a single figure: probably one of those in the table in Annex D. But to arrive at this figure there are three main variables within the Government's control:-

(i) The RSG percentage itself: this usually goes by 1 per cent steps, but in Scotland, $\frac{1}{2}$ per cent steps are common. A compromised solution this year may involve one.

(ii) The Distribution Formula. DOE have tried hard to find a way of altering the formula, so as to give further benefit to the Shire counties. They have failed. (One more route is being explored before the meeting: but it seems likely to penalise the outer-London boroughs, rather than the 'true' metropolitan authorities and is probably not a starter.) That means that the only way of helping the Shires is to go for a high RSG percentage. This is a politically difficult choice but there is no easy way out.

[illegible]

(iii) The Inflation Assumption. Together with the decisions already taken on the volume of expenditure, this determines the level of eligible expenditure to which the RSG percentage is applied.

8. The Cabinet has to balance these three. If it is agreed that the distribution formula cannot easily be varied, then it is a trade-off between the other two, and Annex D shows the range of choice, with a broad indication of the likely effect on rate increases next year. (It is important to emphasise

the broadness of this indication: there will always be some maverick authorities who fall well above or below the figures shown). Broadly speaking, Treasurers are much more likely to play safe and budget for big rate increases if the decisions lie in the top left-hand corner of the table: and to be fairly relaxed about decisions in the bottom right-hand corner. The main arguments are:-

(a) The RSG Percentage. On the one hand the need to contain Central Government expenditure; and the wish to reduce Central Government financing, at the margin, of any increase in local authority expenditure. (The Chief Secretary may ask why rate increases should be limited to 15 per cent when the general inflation in local authority costs is over 20 per cent?.) And, on the other hand, the need to maintain the credibility of the cash limit system and avoid it falling apart in the Government's hands; and the need (stressed particularly by Mr. Younger) to be reasonably consistent in our approach to the local authorities, and not to impose yet another volume cut on them by the back-door, after the successful negotiations of the summer cuts. It is also necessary to watch the consequences on the Shire counties.

(b) The Distribution Formula. As noted above, there is not much chance of varying this in a way which would help the Shire counties.

(c) Inflation Assumption. The argument here concerns the realism of the Chancellor's figure of 14.6 per cent, which I understand he discussed with you at the weekend. It is, as you know, only one of a series of forecasts produced by the model. It is probably the most favourable to the Chancellor's present case. Colleagues know, if only from recent Press speculation, that there are other possible outcomes. It is an amalgam of pay and of price movements next year. It was argued in MISC 21 that the more significant figure might be the current rate of price inflation, because it is this which influences union pay demands over the next few months (particularly for the manuals and the teachers). Moreover, the figure has to be reasonably consistent with that used for the nationalised industries cash limits (which seems to be settling down at about 15 per cent: see the other paper on the Agenda) and with whatever the Government publishes by way of an "Industry Act" forecast later in the autumn. Ministers will also want to watch the implications for the NHS settlement, because while local authorities can, in the last resort, meet an 'excessive' settlement for their manuals by further increases in rates, there is no such safety valve for the NHS. No cash limit for the NHS will have been set at the time the local authority manual negotiations begin. (It may be necessary to set one in December/ January, ahead of the rest of Central Government cash limits.) But the cash limits for both local authorities and the NHS will have to be reasonably consistent with one another and the unions will play both sets of negotiations together.

9. In the end, there will have to be a political judgment about the trade-off between the inflation assumption and the RSG percentage, leading you to identify a particular figure in the table on page 2 of Annex D. You should identify this by reference both to the inflation assumption and to the RSG percentage; the exact figures will have to be recalculated slightly after the meeting to take account of some minor variables. A possible compromise, at which the Home Secretary may hint in introducing his paper, might be to combine a 14 per cent inflation assumption with a 60.5 per cent RSG percentage. This has three advantages:-

(a) It stabilises the proportion of grant going to the Shires overall (though 33 individual authorities out of 47 lose out).

(b) It meets the Chancellor's wish to get the percentage down a bit and thus the Government's share of any marginal addition to expenditure.

(c) It builds in an inflation assumption which is roughly consistent with that for nationalised industries (15 per cent) while still applying a gentle squeeze.

10. There should be no difficulty over the remaining points listed in the paper, all of which have been agreed in the course of discussion by MISC 21.

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CONCLUSIONS

11. You should record Cabinet approval for all the agreed recommendations of MISC 21 (that is, those numbered (i), (ii) and (v) in paragraph 14 of the report) and agreement on the RSG percentage and the inflation assumption which determines the cash limit for 1980-81 (paragraphs (iii) and (iv)). You should also record the Cabinet's agreement that the figures should be published on 16th and 20th November, and that the Secretary of State for the Environment (and for Scotland) should agree the terms of the announcement with you and with the Chancellor of the Exchequer before that.

John

(John Hunt)

24th October 1979