

PRIME MINISTER

E (82) 59

The Chief Secretary has had no less than 5 meetings with Mr. Heseltine about this paper. In the end they have together agreed (against, I understand, DOE officials' advice) on the conclusions in para. 22.

The Chief Secretary wants you to know this; and that, if colleagues will join Mr. Heseltine and him in this approach, he is inclined to give way gracefully on 1982-83 - given the assurances which Tom King has given to the House.

It is worth noting that this will mean a £900 m increase above the Public Expenditure White Paper's provision for 1983-84.

But it wouldn't necessarily make impossible the achievement of the Chief Secretary's aim for the 1983-84 total: the Contingency CR for 1983-84 presently stands at £4 b compared to £2.4 b for the present year, and the "inescapable" bids - e.g., Falklands, statutory social security increases, this local authority increase - could just about be found within the difference between these two figures.

MCS

16 July, 1982.



Treasury Chambers, Parliament Street, SW1P 3AG

16 July 1982

Dear Michael

Here, as promised, is Robert Culpin's note on the proposals for local authority current expenditure next year. I was wrong to say that targets will be less in total than PES provision - see 2 b.

That is the case this year, and is one of the advantages in these new proposals.

You might also like to have the enclosed aide memoire on the CST's PES proposals - the bids/reserve arithmetic (such as it is) is in paragraph 2.

14/7/82
Yours ever
Terry Matthews

FROM: ROBERT CULPIN
DATE: 14 July 1982

MR MATHEWS

cc PPS
FST
EST
MST(C)
MST(R)
Sir A Rawlinson
Mr Barratt
Miss Kelley
Mr Kitcatt
Mr Monger
Mr Mountfield
Mr Faulkner
Mr Goldman
Mr F K Jones
Mr Spackman
Mrs Diggle
Mr Dyer
Mr Ridley
Mr Harris

J. Th...
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LOCAL AUTHORITY CURRENT SPENDING AND THE RATE SUPPORT GRANT IN
1983-84

The Chief Secretary reached agreement yesterday on a proposal which Mr Heseltine will put to colleagues. This gets us over a major hurdle - though there are more to come.

2. Some elements are unchanged from the provisional agreement reached a fortnight ago.

- a. The public expenditure provision for local authority current spending in England in 1983-84 should be £19.5 billion (rounded).
- b. The targets for individual local authorities should sum to this figure.
- c. GREs should be lower - probably about £18 $\frac{3}{4}$ billion.
- d. The difference between targets and GREs should be scored as a margin unallocated to services.

e. Aggregate exchequer grant should be £11.8 billion.

3. The new elements are that:-

f. Different rules/^{should} govern the targets for different authorities.

g. Penalties should be imposed on all authorities which overspend their targets, even if their targets are below their GREs.

h. Penalties should be relatively modest for slight overspending and of "unparalleled severity" for severe offenders.

4. The rules for targets - f - should be as follows:-

(i) For authorities which are spending less than this year's GREs or targets, whichever is higher, the target for next year should be 4% more than this year's budget.

(ii) For the rest, next year's targets should be 5% more than this year's GRE or target, whichever is higher, except that

(iii) No target should be more than 1% below this year's budget.

5. In case Ministers are unable to carry g. through the House, GREs should be held as low as possible. This should minimise the cost if those spending below GREs have later to be exempted from penalties. That cost should be reduced if at all possible to £150 million or so; but it has to be accepted that it cannot be reliably predicted. If a concession has to be made, AEG should be cut below £11.8 billion, though the government would not say so now to the local authorities.

6. The specifics of h. have yet to be worked out.
7. Mr Heseltine should make as detailed an announcement as possible to local authorities before the recess.

Next Steps

8. Mr Heseltine will put this package to E Committee: we don't yet know when. He may or may not minute the Prime Minister beforehand. I am meeting DOE officials later this morning to discuss drafts.
9. As soon as we know how Mr Heseltine intends to proceed, we shall have to consider how and when to consult other departments, especially about the service distribution of GREs.
10. Mr Heseltine is aiming for ^aspecial meeting of the Consultative Council on Local Government Finance at the end of this month, or early in August.

Warning

11. This agreement could come unstuck in many ways, at many stages. Mr Heseltine could have further thoughts. He could be persuaded into further thoughts by ^{his}officials. Colleagues responsible for local authority services could rebel. The local authorities could force concessions on the government.
12. Whatever provision is made, the local authorities will almost certainly overspend.

ROBERT CULPIN

AIDE-MEMOIRE ON THE CHIEF SECRETARY'S PAPER FOR CABINET ON 15 JULY 1982
(C(82)28)

Aims of the paper

The aim set out in the Chief Secretary's paper is to hold to the present planning totals for 1983-84 (£120.5 billion) and 1984-85 (£127.7 billion). Consistently with this, for 1985-86, he is aiming for the total now shown in the PESC baseline (£133.3 billion).

The arithmetic for 1983-84

2. For 1983-84, there is at present a reserve of £4 billion, of which a substantial proportion must be kept back for genuine contingencies during the year. Altogether, bids for new money add up to about £6½ billion. Within this total, there are claims on grounds of 'realism' for increases in local authority current expenditure (perhaps £1 billion), statutory commitments to social security (£0.6 billion on present estimates), the Falklands (not yet finally quantified), and other demand-led increases, all of which will be very hard to resist. So, even if part of the contingency reserve is allocated to programmes, if we are to hold to the planning totals, there will have to be modest cuts in some programmes to cover these demands; but nothing in the least draconian.

The second year - 1984-85

3. It is equally necessary to hold to the planning total for 1984-85. The difficulties of 1983-84 cannot be solved simply by deferring additional expenditure to the following year. Moreover, the decisions reached on 1983-84 will have a "knock-on" effect on later years. It is important to take firm but realistic decisions now so that the planning totals can be held in both years.

Main arguments in support

4. The integrity of the plans. The planning totals were agreed only last November and were published as recently as 4 months ago. Apart from the Falklands, nothing has happened since then which might seriously invalidate the earlier judgements. If anything, the position has in some ways improved, because inflation is coming down slightly faster than expected and pay settlements appear to be moderating. The cash plans embodied the increases of £7 billion (for 1983-84) and £5 billion (for 1984-85) which were agreed in last year's Survey.

They also contained large contingency reserves (£4 billion for 1983-84; £6 billion for 1984-85). They ought, therefore, to be enough for most eventualities. It makes a nonsense of the planning process if the totals are constantly pushed up at annual intervals.

5. Tax reductions. Holding to the planning totals is the only way to leave room for some modest tax reductions next year to help industry and aid economic recovery. Conceding anything like the present bids would require increases in taxation. There is no escape route through increased borrowing. That would only push up interest rates and set back the recovery of industry.

6. Long-term effects of increasing public expenditure. The Government is committed to a long-term reduction in the burden of public expenditure. However, the ratio of public expenditure to GDP was 44½ per cent in 1981-82 - higher than in any year since 1975-76 and 3½ percentage points above what it was at the time the Government took office. The Government cannot both continue on this path for public expenditure and meet its other objectives of lower taxation, lower interest rates and a transfer of resources to the private sector. So it is essential at least to hold steady in 1985-86 and not to enter into new commitments for the future which can only make things worse.

Realism of the planning totals

7. It may be suggested that the planning totals are unrealistically low and, in particular, that they provide too little for inflation. They were, however, published only 4 months ago and there has been very little change in the economic background since then. The 1983-84 total included an overall inflation provision (pay and prices) of 6 per cent. The latest forecast for overall inflation is about 7 per cent in 1983-84 and the intention for pay is to go for something well under 6 per cent. On this evidence, there are no grounds for any general revaluation of the cash programmes. The planning totals also provided generous contingency reserves, both to cover genuinely unforeseen items and to guard against any underestimate of inflation of the kind represented by the bids for "realism" in local authority current expenditure. There is no case for adding yet more to the totals now.

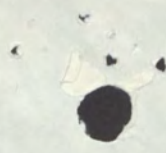
Achieving the Chief Secretary's proposal

8. The Chief Secretary's proposal is achievable if:

- (a) the increase in local authority current expenditure is held at no more than £1 billion;
- (b) colleagues accept his proposal to cut the nationalised industry baseline by £0.5 billion (this is crucial and has^s, of course, now been agreed);
- (c) "optional" as distinct from "essential" bids are withdrawn;

- (d) public service pay is held to lower figures than last year; and
- (e) some cuts are accepted in other programmes to offset the minimum of inescapable additions.

These are tough but not unattainable objectives: they now need to be explored further in bilateral discussion of individual programmes.



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