



PRIME MINISTER

English RSG Settlement 1985-86

The Ministerial Sub-Committee on Local Authority Expenditure (E(LA)) has held a number of meetings under my chairmanship to consider the English Rate Support Grant settlement for 1985-86. Our conclusions cover expenditure targets: holdback; Aggregate Exchequer Grant; the selection of local authorities for possible rate-capping and the expenditure limits (known as 'expenditure levels') to be set for those authorities; and the 'unallocated margin' between total provision for local authority current expenditure and provision for expenditure on individual local authority services.

General background

2. There are two points which have greatly influenced the discussion in E(LA).

3. First, there is the effect of the introduction of rate-capping. In the past, we have used the local authority public expenditure figures as a 'signal' and kept them, and the expenditure targets derived from them, deliberately low to indicate the need for restraint. But the expenditure levels set for capped authorities must be realistically attainable. Otherwise they will be successfully challenged in the courts as unreasonable. Moreover, if the gap between expenditure levels and expenditure targets were too wide, capped authorities spending at their expenditure level would incur substantial holdback. In such authorities there could be large rate increases despite rate-capping. Although it could be argued that ratepayers were still better off than they would have been without rate-capping, the presentational difficulties would be enormous.



4. Secondly, there is the so-called 'Pym commitment'. During the debate on the Rate Support Grant Report 1984-85 on 23 January the Secretary of State for the Environment, with the agreement of the Chief Secretary, Treasury, said that he expected in 1985-86 and thereafter 'to be able to set targets which take greater account of GREs and thus recognize the efforts which low-spending authorities have made'. Although, on a literal interpretation, it does not go so far, this has been widely taken by our supporters in the shires to mean that, at the least, low-spending authorities should not be forced in 1985-86 to make cuts in real terms.

5. To recognize these points E(LA) agreed that it was necessary significantly to increase the expenditure targets, and thus the provision based on them in the public expenditure figures, to more realistic levels. To some extent, this is no more than making explicit the over-spending against targets which has happened in the past. But the Chief Secretary, Treasury has impressed on the Sub-Committee the difficulty of the public expenditure situation. E(LA) has been anxious to ensure that the targets do not reduce the downward pressure on local authority current spending. Moreover, to ensure that past over-spending against targets is not repeated against the new, more realistic targets, it is necessary to set a more severe holdback tariff than last year.

Target methodology

6. E(LA) agreed that expenditure targets for 1985-86 should be set as follows. For authorities with 1984-85 budgets at or below their grant-related expenditure assessment (GRE), the 1985-86 target would be 1984-85 GRE plus $3\frac{3}{4}$ per cent: for authorities with 1984-85 budgets above GRE, the 1985-86 target would be 1984-85 target plus $3\frac{3}{4}$ per cent. However, no target would be lower than 1984-85 budget minus $1\frac{1}{2}$ per cent or higher than 1984-85 budget plus $4\frac{1}{4}$ per cent.

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$3\frac{3}{4}$



7. This methodology can be defended as consistent with the 'Pym commitment' since it explicitly distinguishes between authorities spending above and authorities spending below GRE and produces targets for low-spending shire authorities which require no cut in expenditure in real terms (as measured by the GDP deflator). But it may nonetheless be criticized by some of our supporters. Moreover, the methodology produces tough targets for some Conservative authorities, particularly in outer London.

8. After adjustment for the transfer of responsibility for public transport in London from the Greater London Council to London Regional Transport (LRT), the target methodology produces an increase of £822 million in the PES provision.

Holdback

9. E(LA) agreed that the holdback tariff should be as follows. (The figures show the reduction, in pence, in the grant poundage for each successive percentage point of overspend against target.)

7, 8, 9, 9 ...

The first two points of this schedule are considerably more severe than the 1984-85 tariff of

2, 4, 8, 9 ...

and will greatly strengthen the disincentive to over-spending of 1 or 2 per cent. It will be controversial in authorities which face tough targets.

Aggregate Exchequer Grant (AEG)

10. E(LA) agreed that AEG should be £11.737 billion before holdback, but after adjustments to take account of the transfer of responsibility for public transport in London and the Manpower Services Commission initiative in Further Education. This is expected to be about 48.8 per cent of relevant expenditure. The corresponding figures for 1984-85 were £11.9 billion and 51.8 per cent.



11. Estimates of rate increases are necessarily unreliable, particularly so far in advance. The best judgement that can be made is that if local authorities spend at target they will be able, on average, to keep rate increases in low single figures. But the reduction in the grant percentage will mean large losses of grant in certain authorities with high rateable values, such as East Sussex and Surrey. Assuming that such authorities spend at target, and ignoring the effect of possible changes in balances and increases in rateable values, they could face rate increases of around 7 or 8 per cent.

Rate-capped authorities

12. E(LA) agreed that the authorities selected for rate-capping should be those which are budgetting in 1984-85 to spend at least 20 per cent above GRE and at least 4 per cent above target. This produces the list of authorities in the Annex to this minute.

13. As you will see, the list includes Brent, Merseyside and Sheffield. Your Private Secretary's letter of 31 May expressed your concern about the presentational difficulties of bringing these councils, which are certain to need large rate increases in 1985-86, within the scope of rate-capping. E(LA) carefully considered the arguments for and against inclusion. On the one hand, because the calculation of final expenditure levels has to take account of any special circumstances raised by the authorities, such as transfers from special funds in 1984-85, whereas the targets are based on general principles only, the three authorities may well have to be allowed expenditure levels substantially over target; the consequence will be rate increases well into double figures, because of holdback. This might discredit rate-capping in its first year of operation. On the other hand, the three authorities are notorious over-spenders; and our supporters will not find it easy to understand why they should be excluded from rate-capping. Ratepayers will criticize us if we fail to take the steps which are open to us at least to limit rate increases. Finally, we must beware of appearing to set the criteria for selection for rate-capping on merely political or tactical grounds.



14. By a majority, and with some anxiety, E(LA) concluded in favour of including the three authorities. But they agreed that the decision would need careful presentation. It will be necessary to stress that without rate-capping, the increases in rates would have been still higher.

15. E(LA) also agreed that, in general, the expenditure levels for capped authorities should be equal to the authority's 1984-85 budget, adjusted for the abolition of the National Insurance Surcharge. Assuming inflation, as measured by the GDP deflator, of 4 1/4 per cent this means a real terms cut of that amount. On the basis of historical evidence, it would be difficult to defend requiring the generality of authorities to make real terms cuts larger than 5 per cent: to do so would therefore run a serious risk of successful legal challenge. E(LA) also took the view that it would be prudent to leave a small safety margin below 5 per cent. A cash freeze meets these requirements, and is easy to present.

16. However, E(LA) also took the view that it would be reasonable to set the expenditure levels for the Greater London Council, the Inner London Education Authority, and Greenwich, all of which are budgetting to spend more than 30 per cent above their 1981-82 minimum volume budgets, at 1 1/2 per cent less than their 1984-85 budgets. This distinction will increase the likelihood of successful legal challenge; but E(LA) agreed that the risk would have to be accepted.

17. It follows from these conclusions and the target methodology described above that for most capped authorities there will be a gap of 1 1/2 per cent between expenditure levels and expenditure targets. This should not of itself allow excessive rate increases by those authorities even with the severe holdback tariff favoured by E(LA). But rates may have to go up considerably in some capped authorities, because of particular local circumstances, such as abnormal use of balances or special funds in 1984-85. For the GLC, ILEA and Greenwich, expenditure levels and expenditure targets will coincide.

Unallocated margin and service distribution

18. The public expenditure figures include a gap, known as the 'unallocated margin', between the total provision for current expenditure on individual local authority services (which indicates what the Government believes local authorities need to spend) and the provision for total current expenditure (which indicates what the Government accepts that local authorities will spend). The 'unallocated margin' is £660 million in 1984-85. The White Paper on Public Expenditure provides for £400 million in 1985-86: the size of the margin declines over the PES period in the expectation that local authorities will conform more closely with the Government's plans. Now that the PES provision is being substantially increased in the interests of greater realism, there is a case for distributing all or most of that increase between individual services. Moreover, service Ministers argued strongly that unless this was done they would face very serious presentational difficulties in defending provisions which would imply real reductions in spending from 1984-85 budgets.

19. However, because the total of GREs is equal to the total of provision for individual services, to allocate too much of the increased provision to services would widen the gap between GREs and targets for the authorities covered by the 'Pym commitment'. It would also mean that some authorities, including some of our strongest supporters in outer London, would be set targets in 1985-86 requiring real terms reductions even though the targets were below GRE. This could generate pressures for favourable treatment in the 1986-87 settlement, and even for re-opening the 1985-86 settlement as well.

20. Balancing these considerations, E(LA) agreed that the unallocated margin in 1985-86 should be £600 million. The Chief Secretary made it clear that he could accept this only on the understanding that the agreement on targets for 1985-86 would be carried through

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in the face of the inevitable pressures, and that the Secretary of State for the Environment would use his best endeavours to resist any extension to the 1986-87 settlement of the favourable treatment that is being given in 1985-86 to certain classes of authorities.

21. The Chief Secretary will be arranging a meeting of the Ministers concerned to consider the allocation of provision between services.

Announcements

22. It is highly desirable that an announcement should be made before Parliament rises for the Summer Recess. The Secretary of State for the Environment proposes to make an announcement on matters other than the unallocated margin and service distribution on Tuesday 24 July, as a basis for consultation both with the local authority associations and with individual local authorities which are being considered for rate-capping.

Scotland and Wales

23. The Secretaries of State for Scotland and Wales will pursue bilateral negotiations with the Chief Secretary, Treasury on the settlements for their countries, taking account of the conclusions of E(LA) on the English settlement. They too aim to make announcements early next week.

Conclusion

24. In conclusion, may I emphasise that, as last year, the agreement described in this minute was reached only after several meetings of E(LA) and exhaustive exchanges between the Secretary of State for the Environment and the Chief Secretary, Treasury. It presents difficulties for both of them - and indeed, for

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the Government as a whole. It will be attacked by the local authorities and many of our supporters as too severe: but it also entails an increase in public expenditure provision of over £800 million. I am satisfied that it is the best compromise between the various conflicting considerations.

25. I am sending copies of this minute to the members of the Cabinet, the Chief Whip, the Minister for the Arts, and Sir Robert Armstrong.

WOLW

Privy Council Office
19 July 1984

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ANNEX

AUTHORITIES PROVISIONALLY SELECTED FOR
RATE-CAPPING in 1985-86.

Greater London Council

Inner London Education Authority

Camden

Greenwich

Hackney

Islington

Lambeth

Lewisham

Southwark

Haringey

South Yorkshire

Basildon

Portsmouth

Leicester

Thamesdown

Brent

Merseyside

Sheffield.

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B/C: O. LETWIN



10 DOWNING STREET

From the Private Secretary

20 July 1984

English RSG Settlement 1985-86

The Prime Minister has seen the Lord President's minute of 19 July setting out the recommendations of E(LA) on the English RSG settlement for 1985-86. She accepts the recommendations on expenditure targets, holdback, Aggregate Exchequer Grants, the selection of local authorities for possible rate-capping and the expenditure limits to be set for those authorities, and on the unallocated margin.

The Prime Minister is extremely grateful to the Lord President and his colleagues on E(LA) for their efforts in putting together this most difficult agreement.

I am sending copies of this letter to Private Secretaries to members of the Cabinet, Murdo Maclean (Chief Whip's Office), Mary Brown (Lord Gowrie's Office) and Richard Hatfield (Cabinet Office).

Andrew Turnbull

Miss Janet Lewis-Jones
Lord President's Office.

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PRIME MINISTER

① The position of Barnett is set out in Annex A of the
Policy Unit note.

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Rate Capping and the RSG Settlement 1985-86

The Lord President has reported on the result of his negotiations in E(LA). The package was achieved only with great difficulty and he regards it as being very nearly on a take it or leave it basis - amendment of any one component is likely to disturb the carefully stitched together agreement.

The Policy Unit urge support of the main RSG/targets/hold-back element. They do, however, recommend two amendments:

No net

i) Exclusion of three high spenders from rate capping in the coming year. If you were to follow this course there is a likelihood that the Treasury would press for the savings forgone to be recouped elsewhere.

ii) A larger unallocated margin so that for a given total of local authority expenditure GREs will be lower thereby reducing the sense of grievance of Shire counties and outer London boroughs who are spending below GRE.

Mr. Jenkin is asking for a decision overnight as to meet the deadline he has set himself of a statement by next Tuesday he needs to start tomorrow on the printing of the notices circulated to all local authorities.

Do you

i) accept the E(LA) package as recommended by Lord Whitelaw (in my view you will need to have strong grounds for amending any element of it);

Yes

ii) wish to make any adjustments?

No

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PRIVY COUNCIL OFFICE

WHITEHALL, LONDON SW1A 2AT

13 July 1984

Dear Andrew,

Rate Support Grant

I thought you might find it helpful to see this. This provisional settlement was reached only with the utmost difficulty in a series of private meetings outside E(LA); it is devoutly hoped that nothing will now happen to upset it. If you think the Prime Minister is likely to have any objections, it would be very helpful if you could have a word with Michael Buckley

before taking the matter any
further.

Yours ever,

Saml Lewis-Jones.

Andrew Trobuck Esq.

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PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

12 July 1984

Dear John,

As you know the Lord President has held a number of meetings with your Secretary of State, the Chief Secretary and the Secretary of State for Education to discuss the English Rate Support Grant settlement 1985-86. I am now writing to record the main elements of the provisional settlement which was agreed yesterday and which is of course subject to ratification by the Ministerial Sub-Committee on Local Authority Expenditure (E(LA)).

The proposed settlement is as follows..

Target Methodology

For authorities with 1984-85 budgets at or below GRE, the 1985-86 target would be 1984-85 GRE + 3 3/4 per cent: for authorities with 1984-85 budget above GRE, the 1985-86 target would be 1984-85 target + 3 3/4 per cent. However no target would be lower than 1984-85 budget minus 1 1/2 per cent or higher than 1984-85 budget plus 4 1/4 per cent.

Your Secretary of State agreed that this target methodology could be defended as consistent with the 'Pym commitment' in as much as the targets for low-spending shire authorities, would require no cut in expenditure in real terms (as measured by the GDP deflator). On the basis that has been used in previous E(LA) papers, the methodology leads to an increase of £917 million in the PES division.

However, this figure will require adjustment for the reasons noted below.

John Ballard Esq
Private Secretary to the
Secretary of State for the Environment

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Expenditure Limits and Expenditure Targets

It follows from this target methodology and the earlier decision in E(LA) that expenditure levels for rate-capped authorities should generally be set at a cash freeze on 1984-85 budgets, that the gap between expenditure levels and expenditure targets in 1985-86 would in general be 1 1/2 per cent. But it was agreed that for the GLC, ILEA and Greenwich, all of which are budgetting to spend more than 30 per cent above 1981-82 minimum volume budgets, expenditure levels should be set at 1 1/2 per cent below their 1984-85 budgets; for these three authorities, expenditure levels will therefore be the same as their expenditure targets. This does not affect the total of targets; but it will reduce the likely overspend against target by rate-capped authorities.

Your Secretary of State pointed out that any distinction between the expenditure levels set for different rate-capped authorities would increase the likelihood of successful legal challenge; but it was agreed that this risk would have to be accepted.

Holdback

The proposed holdback tariff is 7, 8, 9, 9, 9.

Aggregate Exchequer Grant (AEG)

It is proposed that AEG should be £11.9 billion, subject to certain adjustments to be agreed between DOE and Treasury officials.

Your Secretary of State agreed to circulate exemplifications to E(LA) of the proposed settlement. At the meeting it was recognised that some adjustments would be necessary to the figures for public expenditure provision and grant to take account of, inter alia, the Liverpool City Council budget for 1984-85. If possible, the basis of all necessary adjustments to the figures should be agreed with Treasury officials and described in these exemplifications.

The questions of the unallocated margin within the total provision for local authority current expenditure, and the service distribution of the allocated provision are still to be resolved.

The Secretary of State for Education and Science has proposed that to enable adequate provision to be made for the Government's policies for education and other services, the unallocated margin should be £400 million, the figure in the Public Expenditure White Paper (Cmd 9143), and that the service distribution should be made pro rata to baselines; he has also made it

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clear that his agreement to the proposed settlement outlined above is conditional upon a satisfactory resolution of the unallocated margin and service distribution issues. The size of the unallocated margin will be discussed further, before the next meeting of E(LA), by the Chief Secretary, your Secretary of State and the Secretary of State for Education. But the question of the service distribution cannot be settled without the participation of other service Ministers. In the meantime, it was agreed that DOE and Treasury should make arrangements to circulate further figures showing service distributions on the basis of working assumptions about the unallocated margin and pro rata adjustments to the baseline. A point that emerged in discussion was that if, as would be entailed by the proposal of the Secretary of State for Education and Science, the whole of the agreed increase in PES provision is allocated to services, the total of GRES in 1985-86 will be correspondingly increased. There is a danger that this could create a fresh 'Pym' problem. It would be helpful if the circulated material could set out this problem more fully.

Now that the outline of the settlement has emerged, the way is clear for the Secretaries of State for Scotland and Wales to circulate for information papers to colleagues on E(LA) setting out their respective proposals for RSG in Scotland and Wales in 1985-86 and to pursue bilateral negotiations with the Chief Secretary in the usual way, keeping your Secretary of State informed.

I am sending copies of this letter to the Private Secretaries of the members of E(LA) and Lord Gowrie, and to Sir Robert Armstrong.

*Yours ever,
Janet Lewis-Jones*

JANET A LEWIS-JONES
Private Secretary

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MR TURNBULL

18 July 1984

RATE-CAPPING AND THE RSG SETTLEMENT 1985/86

Ministers need to decide:

- (i) which authorities should be selected for rate-capping, and how the 'capping' should be operated;
- (ii) what levels of target and holdback should be set for local authority spending.

RATE CAPPING

1. Brent, Merseyside and Sheffield

As a result of accounting manoeuvres, Brent, Merseyside and Sheffield will suffer huge rate increases even if they are 'capped'. This will be very difficult to explain to the public: many will conclude that our rates legislation is a failure.

E(LA) concluded that this danger was less worrying than the yet larger rate increases which would occur if Brent, Merseyside and Sheffield were not 'capped'. Ministers also feared that it would be difficult to explain the exclusion of these extravagant authorities from the list. E(LA) therefore decided that they should be rate-capped.

We disagree. We believe that the Government would do better to incur the wrath of its own supporters for failing to 'cap' these extravagant authorities. This, at least, will be pressure in the right direction - and Ministers can always promise to 'cap' these councils the following year, by which time the perverse effects of their creative accounting will have worn off.

We therefore recommend that the Prime Minister should press colleagues to choose criteria for rate-capping that will exclude Brent, Merseyside and Sheffield this year in the expectation that these authorities will be 'capped' the following year.

2. Portsmouth

The Government will have political trouble if Portsmouth is 'capped'. But the whole policy will be ruined if it is not 'capped', for two reasons:

- (i) It is not possible to devise general criteria that

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exclude Portsmouth without also excluding other authorities such as Haringey and Thamesdown. If these exclusions are added to Brent, Sheffield and Merseyside, we shall be left with only 11 'capped' authorities: too few to make a real impact.

- (ii) If the Government chooses criteria that exclude Portsmouth, it will be immediately apparent that the lists have been 'fiddled', because the wildly extravagant Haringey will also have to be excluded. Commentators will see that we have chosen figures specially designed to exempt Portsmouth, which will bring the policy into disrepute.

These are compelling reasons for including Portsmouth in the list of capped authorities, despite the political trouble that this will cause. And the political dangers can be overrated: we are reliably informed by David Smith at Central Office, (who was present throughout the by-election), that neither Norman Tebbit nor Patrick Rock ever committed the Government in any way to excluding Portsmouth. (The attached press cuttings bear this out.)

We therefore recommend that the Prime Minister should agree with E(LA) that Portsmouth should be included in the list of 'capped' authorities.

3. The GLC and ILEA

E(LA) has decided that the GLC and ILEA should be able to reduce their expenditure in 1985/6 by 1.5% in cash terms, or about 6% in real terms. This sounds right. GLC spending will be up by over 15% and ILEA by over 8% this year: they can therefore achieve significant reductions next year. (Because general principles have to be applied, action on the GLC and ILEA will have to be accompanied by similar action on the equally extravagant borough of Greenwich. This, too, should cause no problems.)

We therefore recommend that the Prime Minister should welcome E(LA)'s decision to impose especially tough expenditure limits on the GLC, ILEA and Greenwich

4. General Level of Expenditure Limits

Apart from the special cases of the GLC and ILEA, the E(LA) proposal is to set expenditure limits on 'capped' authorities that will force them to spend no more cash in 1985/6 than in 1984/5 once allowance is made for NIS

adjustments. The 'capped' councils will, in other words, have to reduce spending by about 4½% in real terms. This seems thoroughly reasonable.

We recommend that the Prime Minister should accept E(LA)'s proposed expenditure limits for 'capped' authorities other than the GLC, ILEA and Greenwich.

RSG SETTLEMENT: TARGETS AND HOLDBACK

Lord Whitelaw has, by a near-miracle, cajoled E(LA) into producing a thoroughly acceptable settlement. The essential features of the proposals are that:

- i. total ^{cash} provision for local authority current spending next year (allowing for NIS adjustments etc) will be 1.3% greater than current spending this year;
- ii. unprecedentedly tough penalties for overspending, combined with rate-capping for the most extravagant authorities, may keep actual spending much closer to our plans than in previous years;
- iii. shire counties that spend well below GRE will be given higher targets, allowing them to increase spending in line with inflation;
- iv. the Exchequer will in theory bear a smaller proportion of total spending than last year; though if councils keep to their targets because of tough penalties, the Exchequer will end up spending slightly more ^{money} than this year.

In other words, the settlement will probably achieve a real-terms cut in local authority spending and keep down the taxpayer's contribution without reneging on Ministers' commitments to the shire counties. (Examples of effects on particular authorities are attached at Annex A).

We recommend that the Prime Minister should unhesitatingly accept this settlement, and that she should warmly congratulate Lord Whitelaw on a remarkable achievement.

Our one reservation is about the size of the 'unallocated margin'. This apparently technical problem will in fact be presentationally important.

Each authority's GRE equals the total amount allocated to its various services; the GRE takes no account of the

'unallocated amount' which the authority is in practice expected to spend.

In E(LA)'s proposed settlement, less money is left unallocated than this year. This means higher GREs all round. The shires, whose targets are now below GRE, will find their GREs rising sharply. As a result, their new (more generous) targets will still be below GRE, and they will complain vociferously.

The answer is to increase the unallocated margin. This manoeuvre will have no effect on actual expenditure, since local authorities attend only to their overall targets and pay no attention to the government's planned 'service distributions'. The presentational disadvantage of reducing apparent allocations for particular services will be more than outweighed by the advantage of avoiding an outcry from the shires.

We therefore recommend that the Prime Minister should urge Cabinet to press for a larger unallocated margin as the Chief Secretary would prefer.

SUMMARY

A. Rate Capping

We believe that the Cabinet should decide to:

1. exclude Brent, Merseyside and Sheffield from rate-capping this year, with the intention of including them next year;
2. include Portsmouth;
3. set especially tough expenditure limits for the GLC and ILEA;
4. set limits for selected authorities other than the GLC and ILEA at a cash standstill on 1984/5 budgets.

B. RSG Settlement

We believe that the Cabinet should:

1. in general, accept E(LA)'s ingenious settlement;
2. but express strong reservations about E(LA)'s proposed reduction of the 'unallocated margin'.

OLIVER LETWIN

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ANNEX A

E(LA)'s PROPOSED RSG SETTLEMENT FOR 1985/6: EFFECTS ON PARTICULAR LOCAL AUTHORITIES

The GLC will receive no grant; it will have to reduce its cash spending by 1.5%; and its rates should go down substantially.

Liverpool will be given a target that allows it to increase its cash spending by 0.5%. If it meets this target, it will receive £5 million more grant in 1985/6 than in 1984/5; and it should be able to reduce its rates by about 5%.

Barnet will be given a target that allows it to increase its cash spending by 3.64%. If it meets this target, it will receive about £2 million less grant in 1985/6 than in 1984/5 (because it suffered very little grant holdback this year); and it will have to fund the increased spending by raising its rates by about 5 or 6%.

Cambridgeshire will be given a target that allows it to increase its cash spending by 4.25%. If it meets this target, it will receive £1 million more grant in 1985/6 than in 1984/5; and it will have to fund the increased spending by raising its rates by about 4 or 5%.