Prime Minister (4)
AT 5/9

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Local authorities file

MR TURNBULL 5 September 1984

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AUDIT COMMISSION REPORT

The Prime Minister asked for an analysis of the recent Audit Commission report on local government spending.

The report stresses:

i. the bewildering complexity of local finance;

ii. the lack of managerial accountability; and

iii. the weaknesses of GRE and rate valuations as measures of the current needs and wealth of each area.

These points are sensible; but they are not new.

The real interest of the report lies in its observations about the damaging effect of the grant system on local spending. The Commission concludes that:

1. Targets induce higher spending, because councils know that next year's target will go up if they over-spend this year; [true - targets are unsatisfactory for many reasons including this].

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2 . Uncertainties about grant cause higher rates, because councils store large sums of money in special funds against the possibility of future cuts; [undoubtedly true - other motives for having special funds are the wish to minimise penalties, the wish to produce low rate increases in election years, and the wish to fund propaganda].

3 . Central government controls over the distribution of grant within local authorities impede sensible spending decisions; [no doubt also true at least one some occasions].

The remedies offered by the report are not particularly helpful. Abolishing targets without either increasing the scope of rate limits or altering the GRE system would set £18 billion of public spending free, and would lead to higher aggregate expenditure. Setting grants for three years ahead would force the government into commit-ments that might distort other programmes. Abandonment of service-allocations within local authority spending would make a nonsense of the claim that grants meet needs in particular services, and is therefore inconsistent with the Commission's advocacy of the GRE system. Sharp reductions in exchequer grant would make life as difficult for low spenders as for the extravagant councils.

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Nevertheless, the report does give the government good grounds for reconsidering the grant system, which is certainly in need of change: this will no doubt be discussed at the October seminar.

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4 The way forward

110. With no increases in Special Funds or (net) contributions to rate balances, rates over the past 2-3 years would have been £400 million lower. To sum up, the Commission has concluded that major changes need to be made to the present arrangements for distributing Block Grant.

111. While it may be argued that tighter central controls – e.g. to make it more difficult for authorities to build up rate balances and to establish special reserves – are indicated by some of the evidence in this report, the Commission does not believe this to be appropriate. What is needed is to put the basic principles of sound business management and of the Financial Management Initiative into practice: less system-induced uncertainty, more financial stability, more delegation, stronger local accountability, less second guessing from the centre, more consistency, less complexity, more local flexibility.

112. The broad changes necessary to meet these requirements are as follows:

(i) The level of the total central government cash support to local authorities and in particular the proportion of relevant expenditure to be met from the Aggregate Exchequer Grant needs to be set out for three years ahead. The balance between specific grants to fund national initiatives and Block Grant support for local operations needs to be clear for the same period;

(ii) The existing shortcomings in information on needs and local property values need to be corrected — distributing £8.6 billion in part on the basis of poor information is a false economy;

(iii) Block Grant support to authorities should be distributed on the basis of a more robust (and ideally simpler) GRE and up to date rateable values. Among other benefits, assuming accurate information, this should result in a more predictable grant entitlement for individual authorities;

(iv) If government wishes to reduce total local government expenditure, this should be achieved primarily via reductions in grant i.e. in the percentage of relevant expenditure to be met by RSG;

(v) Local authorities' expenditure targets different from GRE (revised) should be abolished as soon as practically possible, thus removing some of the perverse incentives in the present system. Local market forces (i.e. the local electorate) should eventually determine the level of local expenditure — provided that local accountability can be suitably strengthened;

(vi) Close-ending should be abandoned as soon as possible; and in any case mid-year adjustments in grant to authorities spending within their budgets should be avoided;

(vii) Local authorities should be left to change their allocation of Block Grant resources without detailed intervention from central government. Where central government have specific priorities they should use specific grants or be achieved via legislation.

These changes are in line with the general principles of the Financial

Management Initiative. They are also the changes that the questionnaire shows that most Chief Executives in local government consider would contribute to the achievement of greater value for money in their authority.

113. The changes proposed constitute a package which would tackle the underlying causes of the problems identified in this report directly. As a result, both rates and the cost of the Whitehall overhead burden involved in oversight of local government should be reduced. Because the changes constitute a package, adopting some of the proposals without others could do more harm than good.

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114. The Commission believes that this report demonstrates the need for some basic changes in the way Block Grant is distributed to local authorities. Although the Commission is well aware of the complexities, the size of the sums involved and the social and managerial implications of failure to correct a situation that is clearly unsatisfactory, suggest that urgent action would be justified. A detailed review should be undertaken to develop proposals for overcoming the weaknesses set out in this report and to deal with the inevitable transitional difficulties. The review would need to show the net effect on grant receivable by individual authorities and the consequential impact on local rate levels resulting from the combination of the application of a simpler and more robust GRE, use of up-to-date information on local property values for grant distribution purposes and the abandonment of the present penalty arrangements. It should be completed urgently. A review of the extent, costs and benefits of any overlap between central departments and local authorities in the oversight of local government services could also be completed within the same time scale. Both these reviews are not within the Commission's sphere of responsibility; but its services are available if required.