

PRIME MINISTER

Seminar on Local Government

The purpose of the seminar is to provide you with a teach-in on how the system of local government finance operates. William Waldegrave and Terry Heiser have provided the attached charts. Although it would be helpful if you had glanced through them beforehand, they intend to talk you through them at the meeting. Oliver Letwin has also provided a note which sets out the sequence of decisions.

We are scheduled to start at around 1800 hours. When the discussion of the RSG system has been completed, we could move to more general questions. William Waldegrave and Terry Heiser will be able to put you in the picture on their ideas for Kenneth Baker's study into the future of local government finance. For this you may find it helpful to look again at the papers produced for the meeting held in September.

It is not intended to go into questions of abolition or obstruction to rate-capping though, no doubt, if time permits over supper it may be possible to discuss these issues briefly.

AT

26 October 1984

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HOW THE RATE SUPPORT GRANT SYSTEM WORKS

The system has been designed to perform two different tasks simultaneously - (1) redistribution between local authorities and (2) public expenditure control. The interaction of these two demands causes endless difficulties.

The system can be divided into a number of steps:

Step I Setting of planning total. The Government decides how much local authorities ought to spend next year. It adds to this a small "unallocated margin", to allow for overspending. The final sum is called 'the total public expenditure provision for local authorities'. How?

Step II Assessment of relative need. The Government then decides how much each authority needs to spend to maintain a standard level of services consistent with the total provision. The amount fixed for a given authority is called its "grant-related expenditure" (GRE). The main considerations in deciding this sum are the size of the authority's population and the nature of the services it has to provide.

Step III Setting Exchequer Grant. The Government also decides what proportion of total local authority spending it will meet from the Exchequer. This "Aggregate Exchequer Grant" is divided into "Block Grant (commonly known as "Rate Support Grant") and specific grants such as those for the police.

Step IV Distribution of Grant. Each authority reports on its total rateable value, and the total amount of block grant is then divided between authorities, each receiving a proportion that depends:

(1) upon its "grant-related-expenditure" (how much it needs to spend to provide an average level of services);

(2) upon its rateable value (how much it can raise from its own inhabitants);

} (3) upon its actual spending; (the Government bears a smaller proportion of expenditure if an authority spends more than 10% above GRE).

Step V

Restraining expenditure. A 'target' is set for each authority. Each individual target is related to the authority's performance in the previous year. The aim is to allow only modest increases in spending for those authorities who are below GRE, and to produce realistic savings from overspenders. The total of all targets is equal to the total public expenditure provision for local authorities, including the "unallocated margin". An authority that spends above its target suffers 'hold-back': part of the grant to which it would otherwise have been entitled, is withheld. The rate of 'hold-back' increases as the authority's spending goes further over target.

Step VI

Selective limitation. Some authorities that spend either vastly over their 'grant-related-expenditure' or vastly over their targets, or both, will be rate-capped. The Government will set a binding limit on their spending and on the rate they can levy.

Oliver Letwin



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Department of the Environment

From the Deputy Secretary,

Terry Heiser CB

Finance and Local Government

26 October 1984

A. Turnbull Esq
No.10 Downing Street
LONDON SW1

Dear Andrew

1. I attach two copies of a set of diagrams which Mr Waldegrave and I would like to use as background in explaining the Rate Support Grant System to the Prime Minister at Chequers next Sunday evening. I do not think that it is essential for the Prime Minister to look through this booklet beforehand.

2. You told me that Oliver Letwin might also be present. I will see that he gets a copy of this document also.

3. You also thought that it might be useful if the Prime Minister were to have by way of background your copies of the papers on the Local Government Finance Studies and the Inquiry into Abuses in Local Government, together with the paper on "Local Government Three Years from Now".

Yours

Terry

T M HEISER

RATE SUPPORT GRANT

Presentation to the Prime Minister

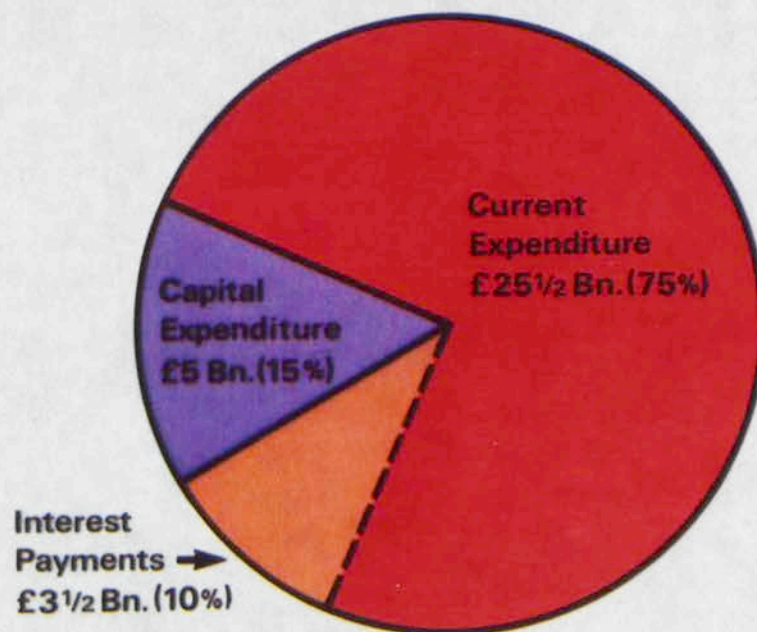
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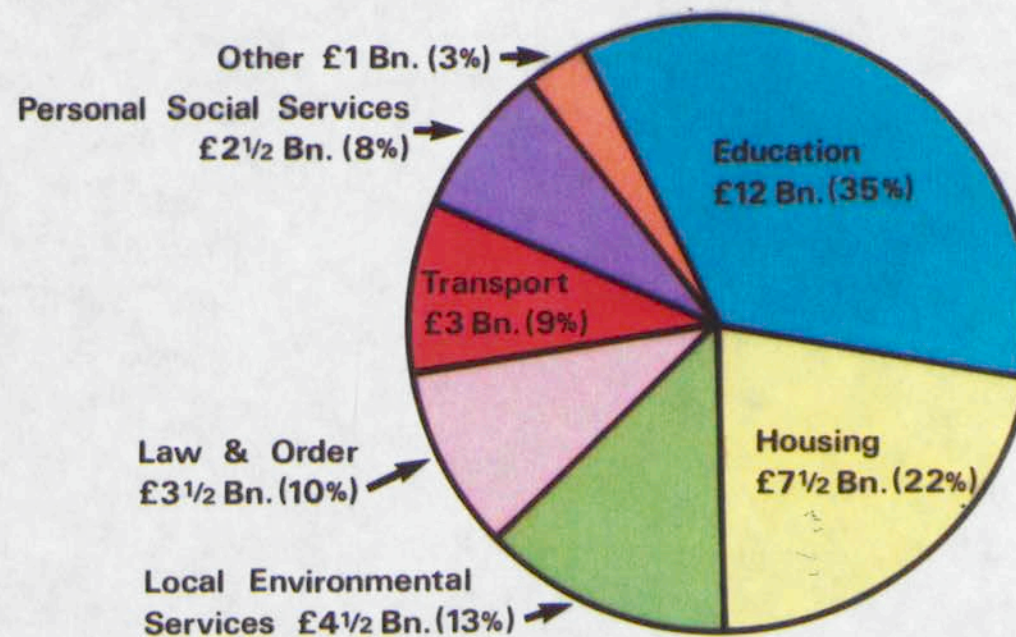
LOCAL AUTHORITY EXPENDITURE (ENGLAND 1982 - 83)

In the latest year for which full information is available, local authority gross expenditure in England was £34 billion. This can be broken down by economic category or by service as follows:-

ECONOMIC CATEGORY

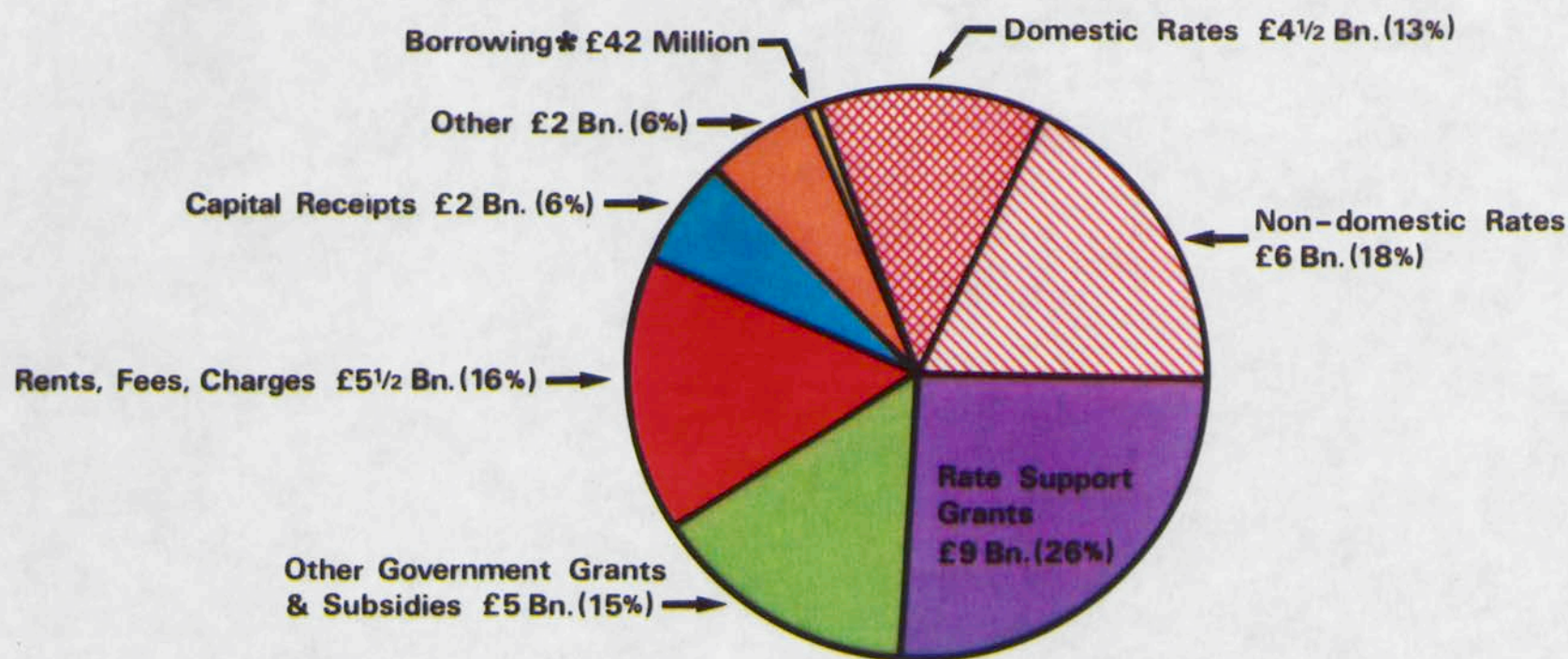


SERVICE



LOCAL AUTHORITY INCOME (ENGLAND 1982 - 83)

The income from which the expenditure is funded comes from the following sources:-

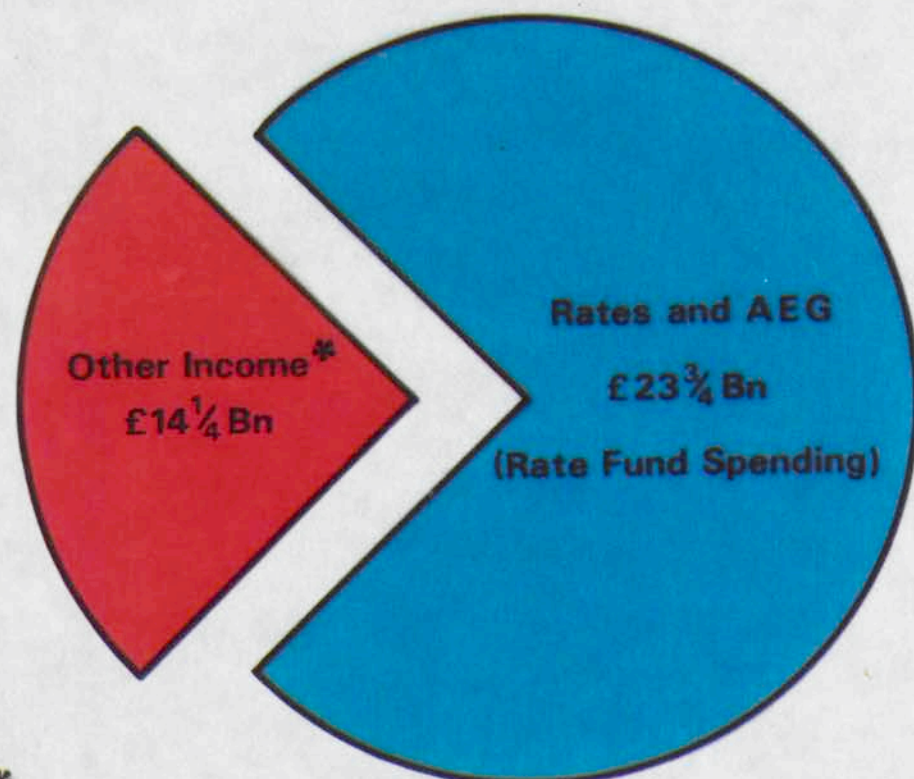


*Net External Borrowing is highly volatile. In 1983-84 it was £1 billion.

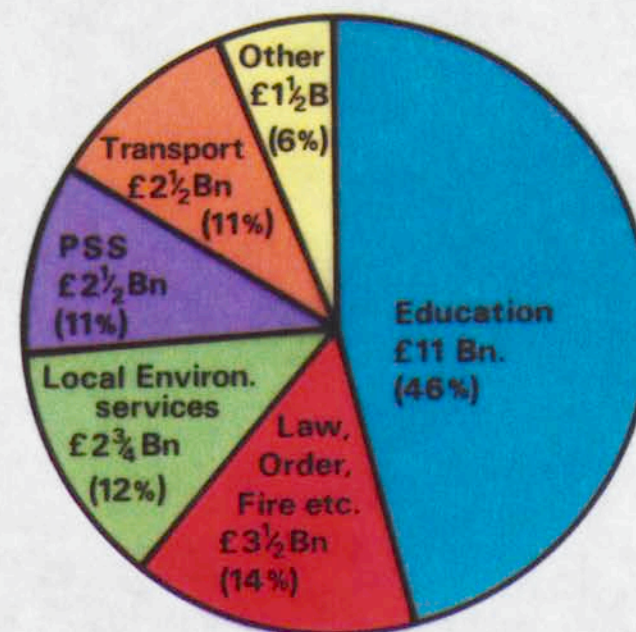
RATE FUND EXPENDITURE (ENGLAND 1984-85: PROVISIONAL FIGURES)

A significant part of Local Government spending is met from fees etc. and makes no demand on the rates. Aggregate Exchequer Grant supports the remaining spending that is met from the 'rate fund'. In 1984-85 this expenditure will be about £24 Bn.

**Gross Expenditure by
Source of Funds** **£38 Bn**



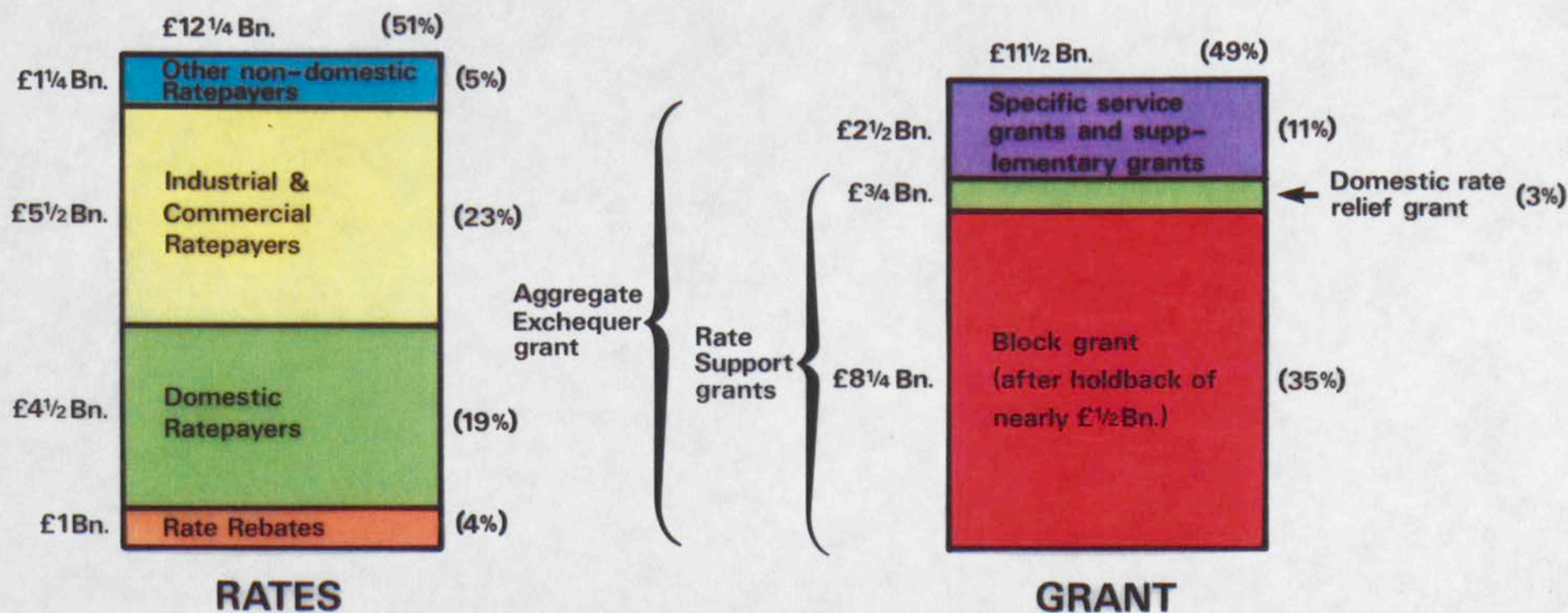
**Rate Fund Spending
by Service** **£23 ³/₄ Bn**



* Borrowing, Capital receipts, Rents, Fees, Charges, Capital grants,

FINANCING OF RATE FUND EXPENDITURE (ENGLAND 1984 - 85)

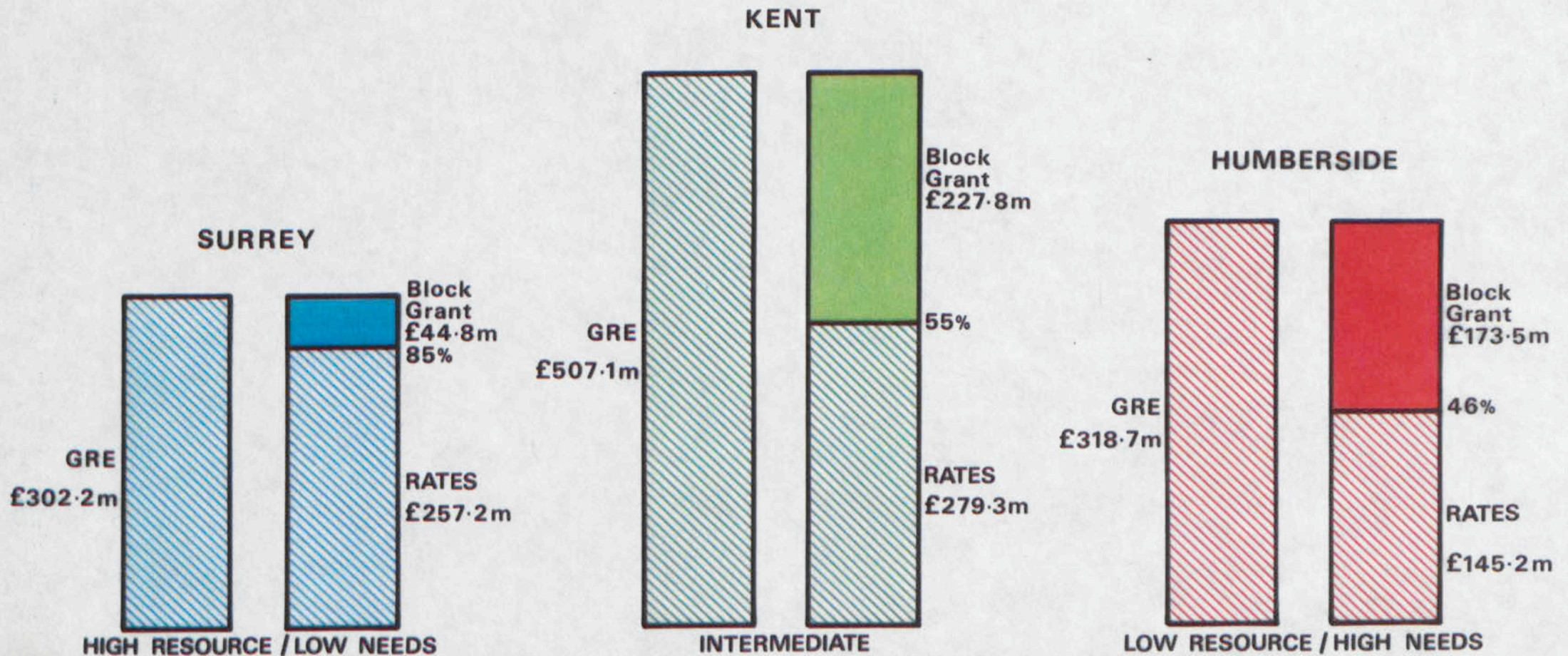
Roughly half of rate fund spending is met from the rates. The remainder is met by Exchequer Grants. The total of nearly £24 billion breaks down as follows:-



BLOCK GRANT FOR AUTHORITIES SPENDING AT THE LEVEL OF THEIR GRE

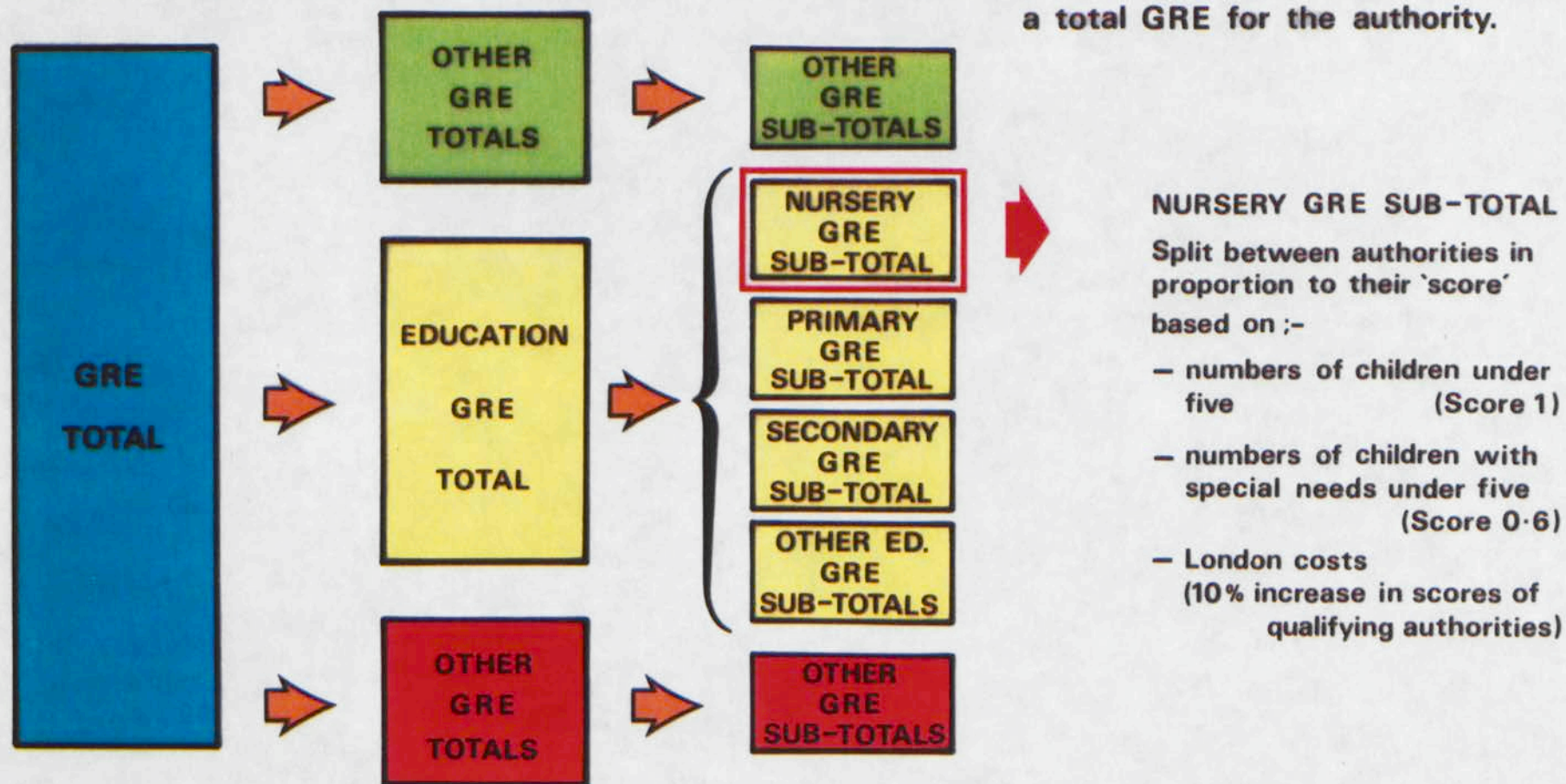
For authorities spending at the level of their GRE, Block Grant meets the whole of the difference between their spending needs, as measured by the GRE system, and the product of a Standard Rate Poundage.

For example, if the three counties shown below had spent at GRE, their Block Grants would have been as shown:-



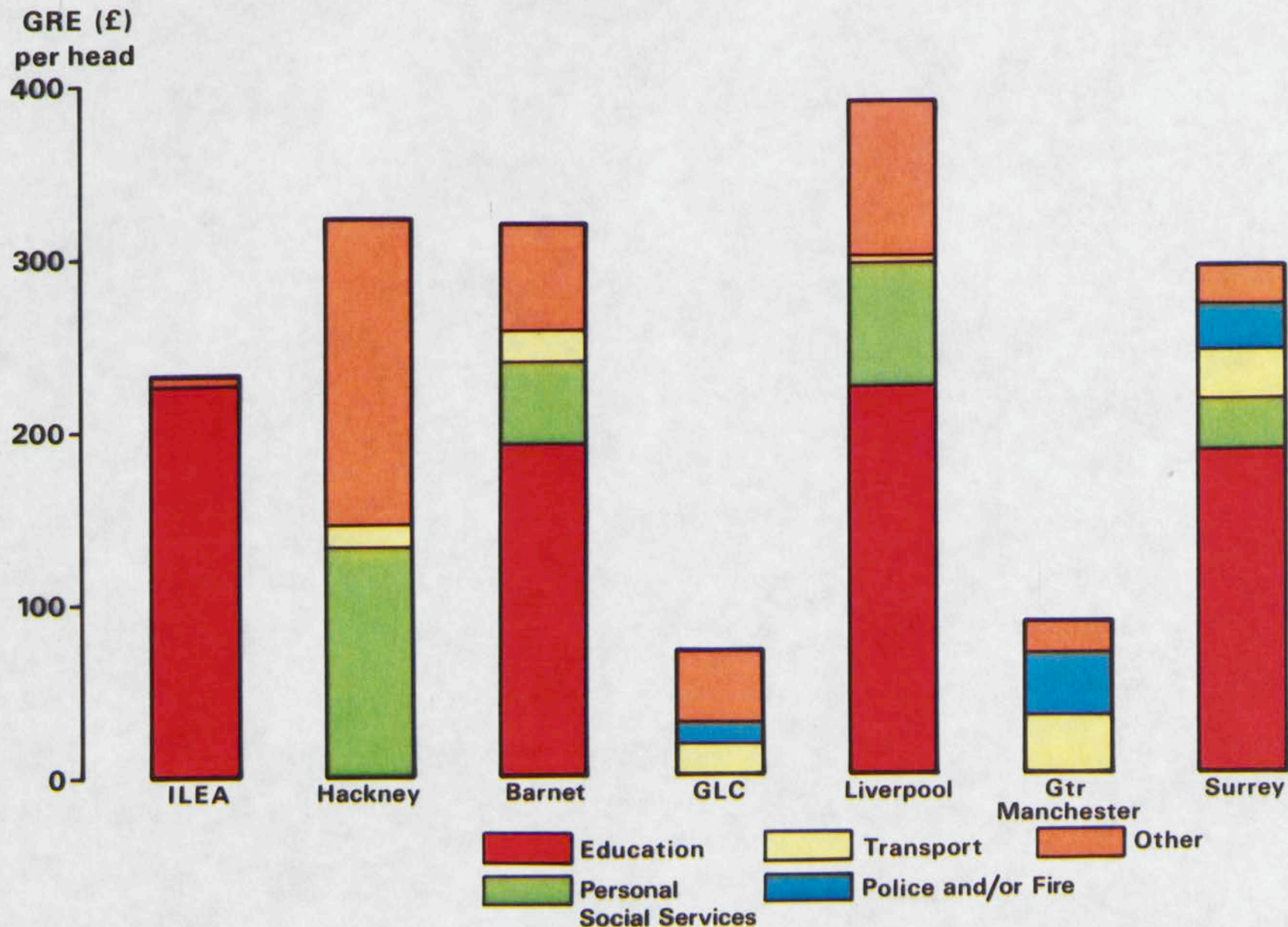
GREs FOR INDIVIDUAL AUTHORITIES

Individual GREs are derived from the PES total. First the 'unallocated margin' (an amount by which it is recognised authorities' spending will exceed the PES figures for their services) is deducted. The total is then broken down into its service sub-components, specific grants (eg police grant) are deducted, and financing payments (eg debt charges) are added. Finally the sub-components are divided between authorities in proportion to their 'score' on various needs indicators (eg number of children under five) and the results are added to give a total GRE for the authority.



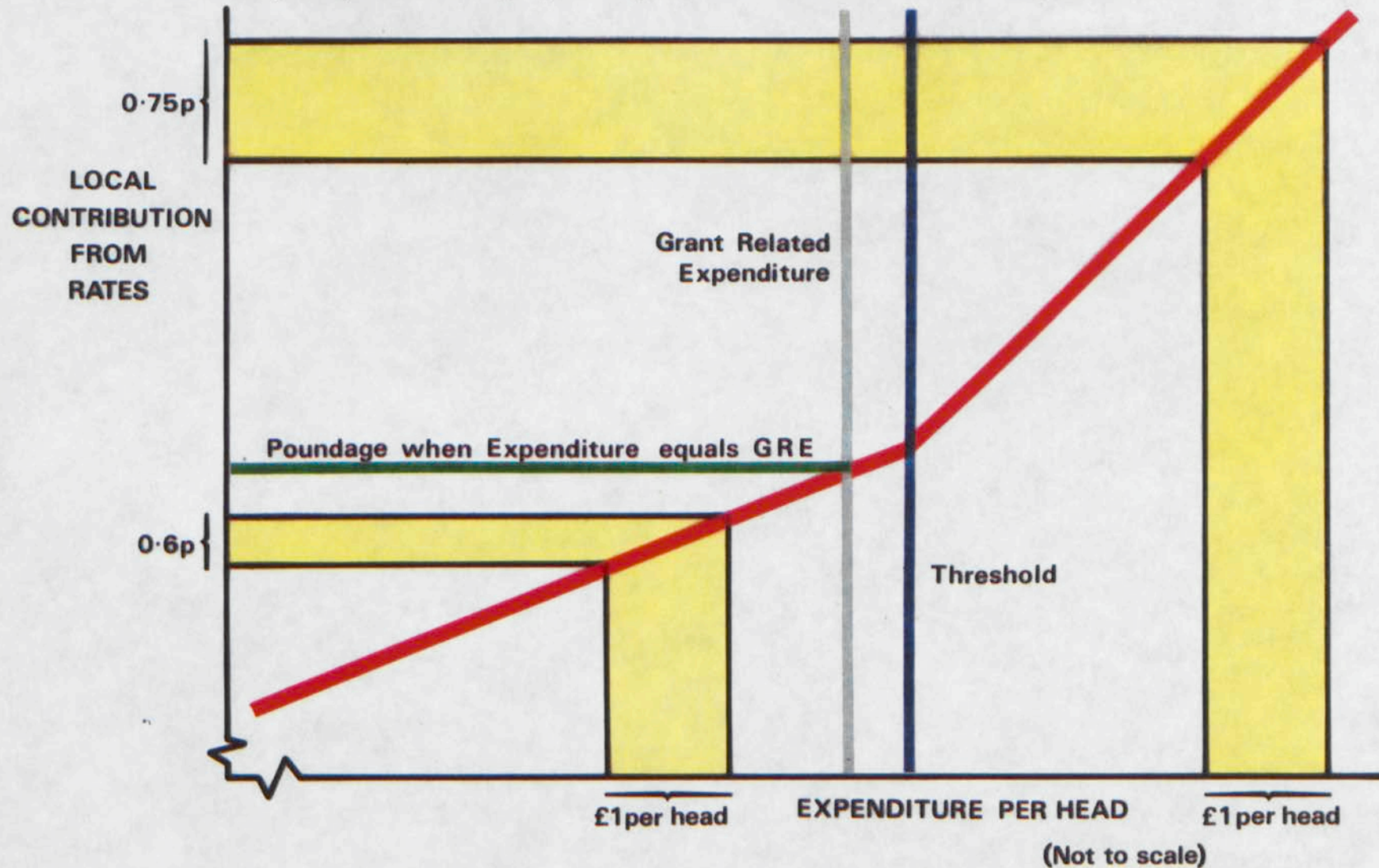
EXAMPLES OF VARIATIONS IN GRE

The make-up of the GREs of individual authorities vary greatly depending on the mix of services for which they are responsible and the scale of the expenditure needs in their area.



THE BLOCK GRANT SCHEDULE

In fact most authorities do not spend exactly at GRE. They have to raise more from the rates for higher spending — 0.6p for each extra £1 per head. Beyond a threshold, they have to pay 0.75p more for each extra £1 per head.



MARGINAL RATES OF RATE SUPPORT GRANT

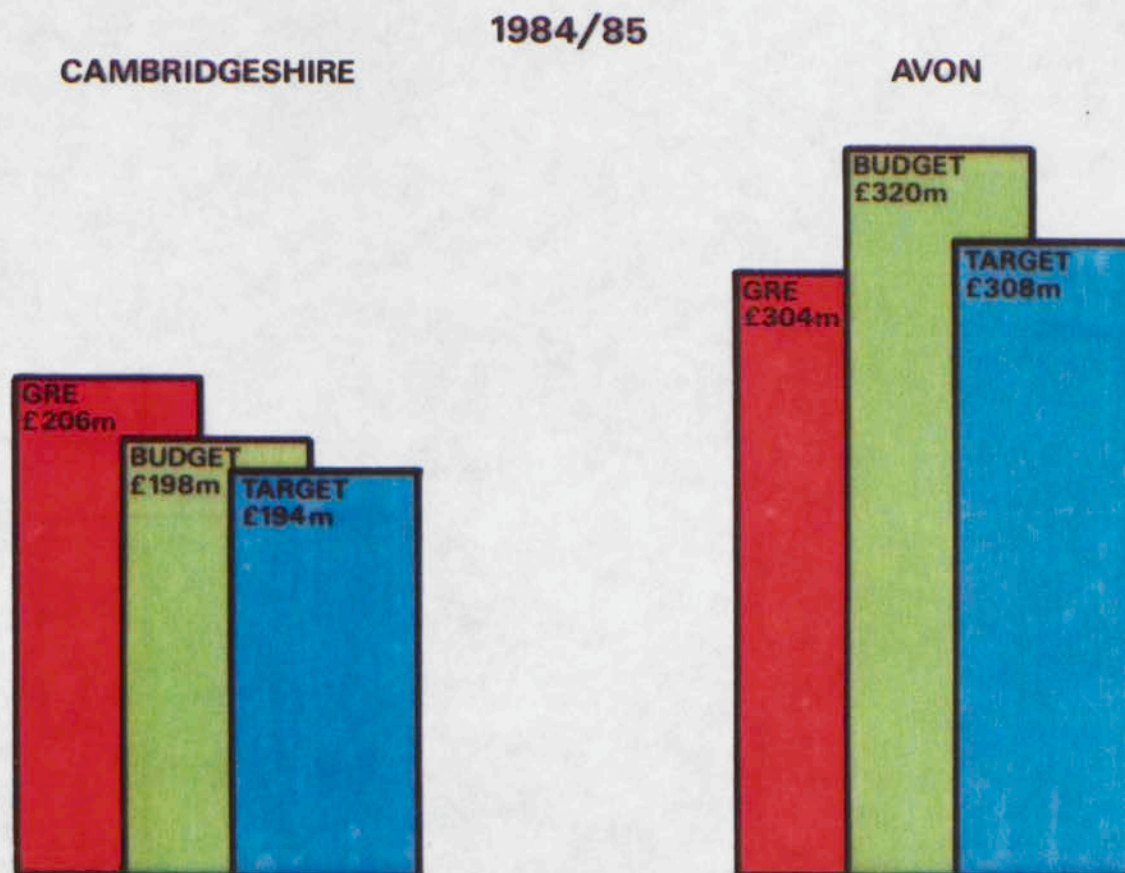
The "tariff" under the block grant schedule requires authorities to contribute the product of a 0.6p rate towards each £1 per head of expenditure. The rest of rate fund spending is met by grant. For some authorities with high rateable values 0.6p on the rates raises more than £1 per head. So their grant goes down if they increase spending. The table below shows this effect for shire counties near the crossover point.

The first four have positive marginal rates of grant, and the others negative marginal rates.

Authority	Product of a 0.6p rate (£000's)	Cost of an extra £1 per head (£000's)	Difference met by grant (£000's)
Kent	1,130	1,486	356
Durham	348	608	260
Cambridgeshire	513	599	86
Bedfordshire	504	512	8
Buckinghamshire	598	581	-17
Surrey	1,043	1,014	-29
Berkshire	754	701	-53
Hertfordshire	1,028	968	-60

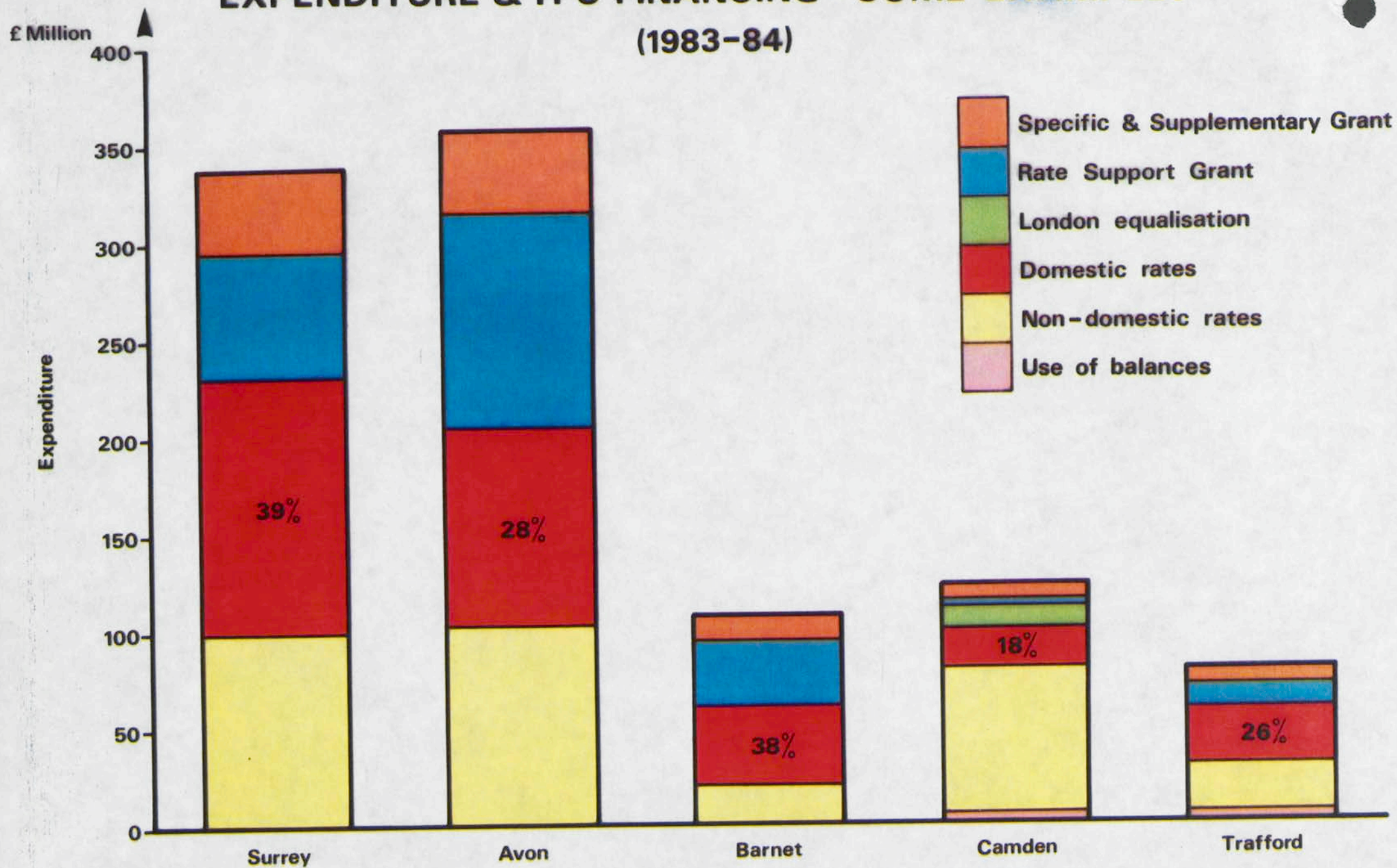
TARGETS

GRE s are about expenditure needs. Targets are related to actual spending levels in the previous year and are designed to reinforce the downward pressure on spending of the block grant system itself.



EXPENDITURE & ITS FINANCING - SOME EXAMPLES

(1983-84)



STRENGTHS AND WEAKNESSES OF RSG

By distributing block grant as we do, we put the poorest authorities on a par with the richest. All can buy the same level of service spending for the same rate poundage. This "hidden hand" of the equalisation process has advantages. It does a lot of things simultaneously. Some it does well. Some it does badly. Some it probably shouldn't be doing at all. Its main strengths and weaknesses might be summarised as follows.

Strengths

- A. Exerts pressure against expenditure growth
- B. All authorities face the same rate poundage cost or saving for higher or lower levels of spending
- C. Supports minimum service standards
- D. Frees authorities of the need to worry about attracting industry, housing etc.
- E. Secures major inter-regional transfers
- F. Cuts the local cost of providing services
- G. A technically "elegant" solution to the problem of distributing grant to over 400 different authorities

Weaknesses

- A. Doesn't do it very well
- B. Not many urban authorities opt for lower rates. Limited accountability: too few full ratepayers
- C. Also supports maximum service standards!
- D. Removes authorities' incentive to attract development
- E. Because of the "hidden hand" these transfers don't arise from policy decisions
- F. So that people don't realise what they are paying for them
- G. It is only understood by the technicians who operate it

The system is designed to complement the rates. It therefore reflects the strengths and weaknesses of rates as a tax.

STRENGTHS AND WEAKNESSES OF TARGETS

Strengths

Combats weaknesses A and B above through realistic pressures related to actual spending levels

Weaknesses

Because targets are related to past spending levels they are not seen as fair by moderate spenders

Copy no. 1. Of 16.....

CHANGES IN LOCAL GOVERNMENT FINANCE

MEMORANDUM BY THE SECRETARY OF STATE FOR THE ENVIRONMENT

1. The Party Conference agenda contains the following motion for reply by me:

Review

"This Conference welcomes the rate capping legislation but urges Her Majesty's Government to make positive steps towards the abolition of the domestic rating system, replacing it eventually with a system of local taxation which bears more fairly on a wider spread of the population."

2. I believe that there would be major advantages in responding to this directly and positively with a firm commitment to change.

Limitations of previous studies

3. Colleagues will be aware that our study in 1981-82 demonstrated that there is no painless route to a new local tax structure by "unplugging" the rates and "plugging in" a new tax. We examined, as main alternative taxes: local sales tax (LST), various form of local income tax (LIT), and poll tax; and as possible multiple taxes, vehicle excise duty (VED) and road fund duty (RFD). All suffered from some disadvantages: eg LST could only operate over wider geographical areas than many local authorities, and would not be very perceptible; most forms of LIT could not be introduced until the nineties and would appear to cut across our commitment to reduce direct taxes: poll tax if rebated could be costly and complex; multiple

minor taxes would not be very perceptible. (The Green Paper "Alternative to Domestic Rates (Cmnd 8449) and Chapter 2 of White Paper "Rates" (Cmnd 9008 refer)).

4. The 1981-82 study was however in practice constrained to find a solution without disturbing the structure of local government, both as regards boundaries and service responsibilities, and without major changes to the grant system. We may also have attached too much weight to certain of the objections to individual taxes, and too little to the problems of continuing with the existing arrangements (including the unfairness of non-domestic rates.) There are plenty of examples abroad of satisfactory local government financial systems that do not rely exclusively on a local property tax and centrally provided block grant, and there is no question but that if we were determined to do so we could find a practical alternative to the present system.

5. We must however recognise that any successful alternative may involve mixes of local taxes; measures to reduce the overall level of local taxes by taking some service expenditure out of local government altogether; and perhaps in the longer run further changes in the organisation of local government. Furthermore, radical changes to the present arrangements are virtually bound to throw into question the equalisation principle whereby residents of better off areas pay more for their services so that more of the rate support grant can be directed to less well off areas. To my mind it would be no bad thing to move to a clearer basis of support than this largely hidden cross-subsidy; but such a step would be very controversial. We should not embark on a new review unless we are ready to respond positively to the conclusions that emerge.

The case for change

6. Despite these difficulties I am certain that we stand to gain more than we would lose if we were to enter the next General Election with well-worked out, specific proposals to legislate for new local government financial arrangements in the life of the next Parliament. This could involve very greatly reduced reliance on domestic or non-domestic rates, or perhaps the complete abandonment of one or both of them.

7. The present financial arrangements, despite the modifications we have made and are making during this and the previous Parliament, seem incapable of meeting our policy aims with regard to expenditure and the link between voting for services and paying for them.

8. Spending objectives. The target/holdback system has undoubtedly slowed down the growth in local government expenditure, but it embodies major unfairnesses which are compounded by the need to increase holdback every year. Rate limitation will also help to contain spending, but it imposes heavy strains on the relationship between central and local government staff resources if it had to be applied to more than a small group of authorities. There will be continuing strong political and practical pressures to drop both targets and rate limitation; and these externally-imposed pressures have in any event not proved capable of providing actual reductions in expenditure.

9. The link between voting and paying. We might achieve better results, in a way more consistent with our traditions, if we could find ways of strengthening the link between voting and paying so that pressures for economy in local services were fully reflected in the ballot box. But this cannot be done without radical change. At present half of local authorities' own income comes from the non-domestic sector which has no vote. On average only about a third of local electors pay full rates. The basic design of the central government grant

support encourages them to think of it as "their" money - the equivalent of a local tax which meets in some cases over 60% of expenditure (because of the way it is divided up between richer and poorer areas) - though they have no concern with raising it.

10. To achieve our longer-term objectives for local government therefore, I judge that a far-reaching review of local government finance, which touches where necessary on structural issues, is inevitable. But it must be kept under close control.

Organisation of Review

11. In view of the political sensitivity of the issues, and because we must ensure that full account is taken of our policies to contain public expenditure, we cannot afford to leave substantial areas of work on new policies in the hands of an outside group. They should be developed under the detailed supervision of a Minister in my Department. Selected non-Government experts could and should be involved in the work - including some drawn from local authorities - but the central core of the exercise must be under the control of a close-knit group which can keep a firm grip on the overall direction and conclusions of the work.

Terms of Reference

12. The terms of reference for the review might be as follows:

"To consider the scope for introducing a more satisfactory local government finance structure together with any associated changes which may be necessary; and to make recommendations."

CMO CONFIDENTIAL

Conclusion

13. If we are to announce such a review at the Party Conference next month, I believe we should start the review before the end of the year and seek to bring it to a conclusion by Spring 1986.

14. I seek colleagues' agreement to announcing a review on these lines at the Party Conference.

P J

21 September 1984

MR
Copy no. 116 Of

ABUSES IN LOCAL GOVERNMENT
MEMORANDUM BY THE SECRETARY OF STATE FOR THE ENVIRONMENT

1. I have concluded that the Government must take an early initiative to review the implications of a number of controversial practices which are becoming prevalent in the way that local government conducts its business. These practices are particularly to be found among urban authorities.

2. Local government legislation is based on the nineteenth century model of local authorities controlled by part-time councillors operating for the benefit of the local community as a whole. The statute contains no reference to the role of political parties within local government, and no provision for regulating party manoeuvrings. However, a covert "Westminster" model has recently begun to emerge in some authorities, with a virtually full-time executive, many of whom are also public sector employees, taking decisions on a party basis but without the constraints which apply to central Government at Westminster. This provides a great opportunity to the Left who perceive local government as a convenient salient in their campaign to foster extra-Parliamentary opposition to our policies - and indeed the policies of any government founded on the principles of Parliamentary democracy.

3. Colleagues will recently have seen papers describing a number of these controversial activities which demonstrate that conventions traditionally observed by all political parties in local government have begun to break down. This trend is undermining important democratic safeguards hitherto enjoyed by ratepayers, by those reliant on local services and by those working for local councils.

4. The most pressing examples of the disintegration of traditional attitudes are -

i. manipulation of standing orders, inter alia, to prevent

proper consideration of Committee papers and deprive minority party members access to information;

ii. increasing willingness to use ratepayers' money for propaganda campaigns and for financing politically-motivated "voluntary" groups;

iii. appointments or accelerated promotions of officers sharing the political views of the majority group, often linked with the growth of clandestine decision-taking systems operating within the Party caucus, with the close involvement and support of politically sympathetic officers; and

iv. an increasingly cavalier attitude towards conflicts of interest, including the so-called "cross employment" situations whereby local government officers in one authority serve as councillors in a neighbouring authority; and the growing identity of interests between members and the public sector trades unions.

5. We shall doubtless be pressed hard at next month's Party Conference to stop these abuses, but I am clear that we cannot proceed directly to what would be highly controversial legislation without a careful, detailed and - as far as possible - bipartisan review of the issues. I propose, therefore, to announce at the Party Conference that I intend immediately to commence consultations with the local authority associations on the terms of reference for a major inquiry into local government procedures and practices in England to be launched as soon as possible.

6. The prospects of such an inquiry producing sound recommendations robust enough, if implemented, to survive any subsequent changes of political control at national level

will be vastly enhanced if we can carry the Labour Party with us on the need for, and scope of, a review. It would be both prudent and realistic to avoid any implication that every change which we are now seeing in the political management of local government is, in every respect, reprehensible. The aim must be to work towards framing a set of rules within which the Party interests can be both openly accommodated yet appropriately constrained.

Terms of reference

7. I propose to open consultations on the basis that the inquiry should consider the extent to which the political parties are exercising an increasing influence within local government; and to recommend in the light of those findings whether and what democratic safeguards - statutory or otherwise - should be introduced in relation to such matters as -

- i. the rights of minorities on local councils;
- ii. the independence and political neutrality of officers;
- iii. the limits that should apply to the use of ratepayers' money on politically motivated activities, including advertising; and
- iv. conflicts of interest on the part of elected members.

Organisation of the Inquiry

8. I envisage a high-powered Committee of up to 7 members chaired ideally by a constitutional lawyer. A minority of the members would be drawn from local government itself; the remainder would be eminent lay representatives.

9. My Department would provide the secretarial and supporting

research studies.

Timing

10. I expect that the Committee would sit for about 12 months so that the results of their work should be available in time to feed into our policy statements before the next General Election.

CONCLUSION

11. I seek colleagues' agreement to announcing at the Party Conference my intention, after consultation with the local authority associations, to set up a Committee of Inquiry into Local Government Practices and Procedure on the basis described in paragraphs 5-8 above.

PATRICK JENKIN

21 September 1984

ELIMINATION OF TARGETS

Introduction

1. Particularly among Conservative authorities, targets attract more criticism than the rest of the RSG arrangements. Fulfilment of the Pym commitment (to give fairer targets for low-spenders below GRE) may have bought off opposition for 1985/86. But getting rid of targets remains the single step which would most please Government supporters in local government.

History

2. Targets were introduced to try to secure delivery of PES plans in 1981/82. Block grant, based on GRES, was not thought to exert enough pressure: many authorities were spending so far above GRE that they could not be expected to reduce to GRE level in 1 year; so unless those spending below GRE were persuaded not to increase to GRE level, the PES plans were bound to be exceeded. Targets have sought to limit year on year cash increases in spending by lowspenders; and to set realistic cash cuts for high-spenders. Our measures (cuts in RSG, block grant and targets) have reined back spending. If the established growth trend (+3½% pa) had continued since 1978/79, real expenditure now could have been £4 billion higher. (It has risen by 4% since 1978/79).

Criticisms

3. The legislation obliges us to set targets on general principles applicable to all authorities: it is impossible to find principles which are fair for all 413 authorities. The need to be realistic means that high spenders' targets are bigger increases over previous targets than low-spenders'. Targets differ from GRES in that they cannot reflect changing relative needs. Targets and holdback are difficult to reconcile with block grant, which is based on GRES and is intended to make up for differences in authorities' needs and resource bases. The inequities are cumulative, since comparison of expenditure against target in year 1 affects the formulation of targets in year 2; and so on. Targets have now existed for 5 years; we have changed methodology each year, and the figures are undeniably open to attack. It is questionable whether targets and holdback can be made both fair and effective.

Conclusion

4. We have always said we were reluctant to impose individual targets, and that we should abolish them as soon as we could. The introduction of rate limitation, and the abolition of the GLC and the metropolitan counties, might offer us the opportunity to do it. But we must also sustain the pressure for reductions in spending: this could mean further reductions in the grant percentage (already down from 61% to 49%), and tougher block grant pressures. These will also be unpopular, and we must see which is the lesser evil. The Department is working up exemplifications, for discussions with other Departments.

AUDIT COMMISSION REPORT ON BLOCK GRANT

Main Points

The report argues that there are too many uncertainties in the present RSG system. These uncertainties have led to local authority reserves, and in turn rates, being over £1200m higher than they need to be, and to a general diminution in managerial effectiveness.

The report concludes the problems that it has isolated can be dealt with by inter alia getting rid of targets, setting grants three years in advance, minimising mid year grant changes, having a rateable value revaluation.

DoE Comments

Some of the conclusions are sensible. We would like to get rid of targets. We are all in favour of minimising mid year grant changes where possible. But the report ignores the effect our policies have had in restraining local government spending so far. (See paragraph 2 of the note for agenda item C). Much of the text is tendentious. For instance, the critique of the GRE system is based on partial, anecdotal evidence.

There are three vital flaws in the report's analysis:

- a. the benchmark year used to calculate that reserves are over £1200m higher than they needed to have been is 1980/81. This is a wholly untypical year when reserves were at a historic low point. It is by no means self-evident that the build up in reserves since 1980/81 is a response to uncertainty rather than a return to their more normal levels (ie those of the late 1970's);
- b. the promotion of managerial effectiveness is at most a peripheral objective of the RSG system and is not a central criterion by which the system should be judged;
- c. in stressing the increases in authorities' reserves, the report fails to bring out that expenditure, and therefore rates, have been held down by government policies, and would have been lower still if all authorities had made the modest economies implied by the Government's targets.

17.9.84

LOCAL GOVERNMENT POLICY THREE YEARS FROM NOW.

INTRODUCTION

1. In June the Secretary of State asked for an internal paper to be prepared which would consider where present policies on local government structure and finance might lead in three years time, 1987. A preliminary discussion on this subject took place at the Sunningdale seminar in August, led by Lord Bellwin and Mr Waldegrave.

2. This paper has been prepared in the light of that discussion. It considers the background and context to the present policies; considers the circumstances which they might lead to by 1987 and the issues that might be raised; and considers the scope for, and desirability of, further examination of those issues.

THE BACKGROUND

i) The Government's Economic Policy

3. This paper confines itself on structure to the abolition of the GLC and the metropolitan county councils; and on finance to the operation of the rate support grant system and rate limitation as a means of discouraging high levels of spending by authorities. It does not deal with the question of 'abuses' in local government.

4. These policies stem from a major strand of the Government's overall economic strategy, namely that public spending and taxation should be reduced, and that the public sector should be reduced in size and made more efficient, economical and cost-conscious. Since 1979 the Government has consistently taken the view that those objectives should apply to local government just as much as to any other part of the public sector. But in trying to secure those objectives in this particular part of the public sector it faces a unique set of problems:

- i) it is dealing with over 400 elected bodies, traditionally jealous of their perceived independence;

(ii) that independence includes a freedom for authorities to determine their own spending levels and priorities in providing services to their communities and to levy their own local tax at whatever level is necessary to finance that spending;

(iii) a significant number of authorities are controlled by elected members opposed to the whole thrust of the present Government's economic policies.

5. These considerations have been particularly relevant to developments in local government finance policy since 1979 to date and will remain so to developments over the next three years; but they also have a bearing on aspects of the abolition policy.

(ii) Timescale

6. In looking forward to where current policies might lead by 1987, it is useful to keep in mind the timescale of the main events which may have a bearing on developments over the next three years - see Annex A.

7. By mid-1987, the post-abolition arrangements will have been in place for a year; we will be entering the second year of controlling joint boards' precepts and manpower and the third year of rate limitation; elections to the non-metropolitan county councils will have taken place (in 1985) and there will have been elections to London Boroughs, two rounds of elections (by thirds) to metropolitan districts, and elections (either by thirds or whole councils) to all non-metropolitan districts; and the next General Election will be approaching.

POSSIBLE OUTCOMES OF PRESENT POLICIES BY 1987

8. Possible outcomes of the current policies can obviously lie anywhere along a spectrum from outright failure to complete success.

9. Abolition might be judged as a failure initially if the policy were not implemented on time for whatever reason - delay or damage to the legislation, obstruction and non-cooperation by the authorities involved, or a practical impossibility in making all the necessary arrangements in time. Success - in 1987 - would be achieved if abolition were achieved on time and according to plan, with a reasonably smooth transfer of functions to successor bodies; it would be too early at that stage to judge whether the policy has been a success in terms of delivering a more effective and economical structure.

10. On the finance side, failure might be represented by the breakdown of the RSG system as a means of discouraging high spending; a significant number of rate-limited authorities in commission; and perhaps the general scheme on the point of introduction. Success might be characterised by a relatively small number of authorities subject to rate limitation and complying with it to reduce spending and rate levels, while the mechanisms of the RSG system would be having the desired effect in encouraging other authorities to hold their spending and rates down.

11. In practice, it is unlikely that we will be in a position by 1987 to conclude that the policies have either failed or succeeded in terms such as these. It seems more likely that in the narrow administrative context of policy implementation, the Government will be "getting by", in the sense that the policies will be in place but their effectiveness will not yet be certain. But in the wider context of the central/local government relationship it is likely that much more fundamental issues will have come to the fore - issues which could dominate the future development of local government policy as a whole. And, notwithstanding the implementation of the policies, there could be "flashpoints" where the relationship has reached some sort of crisis.

(A) Structure

12. With hard work and determination the main abolition bill will receive Royal Assent on time and without any major changes to the present policy. Once Royal Assent has been achieved - if not before - co-operation from most metropolitan districts and London boroughs (although there may still be obstruction from a few boroughs) should be forthcoming. Even with co-operation, some "turbulence" and confusion is to be expected in the initial stages and the transitional costs of abolition are likely to be more evident than the savings. But, making due allowance for such "teething problems" implementation of abolition should be going broadly according to plan, producing more accountable, efficient and cost-conscious local government in the 69 authorities involved.

13. However, the abolition proposals raise issues which are likely to reverberate beyond those authorities. There will be an increase in central government involvement especially in planning and transport matters. Joint boards will, in effect, be single-purpose local authorities and their expenditure (and possibly manpower) will be directly controlled by central Government, probably on the basis of the appropriate service GREs, for the first three years of their existence. Such a role for GREs was never envisaged at the time, and their use in this way may inevitably raise questions about the future role and autonomy of local authorities - are they now to be seen as no more than agencies of central government, delivering statutory services to a prescribed standard at a prescribed cost? Alternatively, there may be counter-pressures for direct elections to joint boards to make them more democratically accountable, a move which would threaten to recreate the abolished authorities by the back door.

14. The abolition exercise may also raise questions about the future structure and functions of local authorities outside the metropolitan areas, and in particular about the principle of unitary local government. There are, for example, long-standing pressures for change among non-metropolitan districts, where the large cities, such as Bristol, Portsmouth, Southampton,

Leicester, Nottingham and Plymouth, hanker for a return to their former multi-function county borough status. The non-metropolitan counties would predictably be strongly opposed.

(B) Finance

15. During the 1960s and 1970s the Government's public expenditure plans for local authority expenditure were formulated after extensive and fairly open consultation with local government service by service which usually resulted in a broad consensus about the level of expenditure provision needed to finance planned levels of service and a reasonable conformity of outturn to plans. This was of course facilitated by the rising levels of real expenditure planned for in these years.

16. Since 1979 the Government have wanted to secure real reductions in expenditure and have accordingly adopted a more interventionist approach. The total levels of expenditure planned for local government have been determined as a single total, which tends to have rather more regard to overall public expenditure constraints than to individual service needs; and individual targets have been set for each council within the total level (see below).

i) The Rate Support Grant System (RSG)

17. From 1981/82 the Government has exerted pressure on authorities to reduce their spending through the rate support grant system. It introduced a new RSG system - block grant - which reduced the rate of grant support for higher levels of spending and grafted on to that a system of spending targets for individual authorities, accompanied by grant penalties (holdback) for exceeding those targets. The pressure applied through both mechanisms is the same in that it gives authorities a choice between cutting their spending or putting up their rates - or striking some balance between the two. The Government's hope was, of course, that authorities would not want to risk courting electoral unpopularity with high rate increases and would therefore cut spending instead.

18. With certain notable exceptions - and despite the tone of the recent Audit Commission report - the system has had some success in slowing down the rate of growth of spending by the generality of authorities, but at a price. The reduction has been due in particular to the target/holdback mechanism, but this very mechanism is fraught with problems. It embodies a number of unfairnesses affecting both high and low spending authorities which are increasing every year; and those unfairnesses are being compounded by the fact that the holdback penalties have to be tightened each year in order to maintain pressure on high spending authorities. In addition, the mechanism undermines the equalisation principle of the RSG system; and since targets are related to previous spending levels the prospect of abolition, which will entail lower tier authorities taking on new functional and spending commitments poses further major problems for the target system. Political and practical pressures to drop targets and holdback are therefore strong; and they will be stronger still by 1987.

19. Ministers have said publicly that they would like to abandon targets as soon as possible. But it seems most unlikely that they would want to see any relaxation of pressures on local government spending. But to the extent that targets and holdback have been effective if they were dropped, some increase in local government expenditure could be expected; they would therefore need to be replaced immediately by other measures to deter high spending. Ministers have received detailed submissions on this.

Substitute measures could include an overall reduction in the level of RSG to local government and a tightening of the "conventional" block grant mechanisms to make the cost of high spending more expensive to local authorities, and hence their ratepayers. Such steps cannot however replicate the operation of targets and there would be distributional changes. Control of ^{"abolition"} joint boards' precepts ^{however} would provide additional pressure to hold down the general level of local government spending albeit in limited functional and geographical areas.

ii) The effect on rates

20. Whether targets are retained or other disincentive measures are adopted, the nature of the pressure which will be applied to the bulk of authorities will be essentially the same: a choice between cutting spending and putting up rates. There are, however, two major problems in such an approach.

21. First, it rests on the assumption that local authorities will take the view that local electors will prefer cuts in rates, rather than cuts in spending. But whatever the view of the local electorate, the fact is that in practice the linkage between local taxation and representation is generally weak, and is particularly weak in some inner city areas. On average only about a third of local electors pay full rates and more than half of local authorities' rate income comes from the non-domestic sector which as such has no vote. Local authorities may well therefore perceive that a much greater proportion of their electorates are concerned about services than about rates. The majority of authorities have nevertheless so far responded more or less as the Government would have wished. But if authorities regard the pressures on their spending as reaching unrealistic or unacceptable levels, they may decide to preserve spending levels and pass grant penalties straight on to the rate payer in the form of higher rates. Indeed, this is typically what has been happening in authorities which are now candidates for rate limitation.

22. Second, to the extent that authorities pass on grant penalties to their ratepayers, the weaknesses in the rating system are accentuated. In particular, because grant reductions and penalties, whether due to the normal operation of the block grant mechanisms or to targets/holdback, are calculated on a basis which equalises the cost in rate poundage terms of a given degree of overspend, there is an implicit assumption that rateable values represent a fair tax base in terms of relative ability to pay. Yet that is far from the case: rateable values are now more than ten years out of date and disparities now arise between authorities in different parts of the county and between similar properties in the same area which no longer seem plausible. In the non-domestic sector

in particular rateable values do not take into account either the effects of the recession in once-prosperous areas like the West Midlands or the recent rapid growth in areas like the Thames Valley. This should be put right by the planned non-domestic revaluation, but not until 1989. But there is no prospect of an early domestic revaluation.

23. Successive Governments have regarded the equalisation objective of the RSG system as a basically fair and legitimate means of redistributing resources between more and less affluent parts of the country. But it is an objective which has never found acceptance with local councillors and ratepayers, particularly in high rateable value areas. And the less rateable values reflect ability to pay - as for industries in the West Midlands - the more unacceptable the basic principles of the grant and rating systems will become. These problems may well become acute by 1987.

iii) Rate Capping

24. In April 1987 rate limitation will be entering its third year of operation. A majority of rate-limited authorities - which might be more than the initial 18 - will probably have complied with the law, with perhaps one or two in commission. But by this stage the Government could be facing conflicting and difficult pressures:

(i) the continuing pressures being exercised through the grant system on non-rate-limited authorities may, on the analysis in paragraphs 20 to 23 above, drive rates up in some areas and increase dissatisfaction with the rating system; this in turn could increase pressure from ratepayers, particularly in the non-domestic sector, for more authorities to be rate limited. And if at the same time the selective scheme were proving slow to deliver savings in public expenditure, the Treasury might by then be pressing for the introduction of the general scheme.

(ii) whether or not the pressures at (i) above materialises, it seems likely that the second and third years of rate limitation could well see some increase in the number of authorities affected - it hardly seems plausible that the number will stick at 18 over that period of time. But even a modest increase - say to 25 or 30 - will strain departmental resources substantially and will put further strains on the relationship between central and local government. There may therefore be strong practical and political pressures to contain, if not reduce, the number of rate-limited authorities.

25. The general approach adopted by the Government since 1979 has had some success in curbing the rate of growth and changing attitudes among many elected members and officials in relation to the need for much greater efficiency. But it has run into a number of difficulties. It has become clear in successive years that the Government's plans for reductions were not going to be met in full, and upwards adjustments have had to be conceded on grounds of realism. These adjustments have partly been made necessary by flagrant overspending by a few authorities. But they also reflect some degree of over-optimism about political institutional and motivational problems of achieving real savings in some individual local authorities services.

26. Thus even if the Government is "coping" with rate limitation, and has not encountered widespread confrontation, it may well face by 1987 conflicting pressures which will make the way ahead very difficult. Looking ahead over the next five years the success or failure of the Government's financial policy in relation to local government may be critically dependent :

(i) on the realism of the Government's plans, and the extent to which they can therefore be converted into credible service policies on the basis of which Departments can reasonably hope to rebuild a consensus with the majority of local authorities;

(ii) on the identification of genuine opportunities for achieving better value for money and efficiency

savings in local authority services (perhaps mainly via the Audit Commission), and development of effective means for encouraging authorities to adopt these.

POSSIBLE IMPLICATIONS FOR CENTRAL/LOCAL GOVERNMENT RELATIONS

27. By 1987 central government will have become more directly involved in the affairs of local authorities, specifically the enhanced role Government Departments will play in London and the metropolitan areas, especially on planning and highways; through the precept and manpower controls of joint boards; and through rate capping. This will no doubt give rise to tensions and difficulties, some non-co-operation and possibly confrontation. The Government will also be continuing to apply normative pressures to local authority spending through the RSG system, whether or not targets and holdback are still in use. This may well lead to a further souring of relations with large sections of local government; pressure for an extension of rate capping to other authorities; and renewed pressure for more fundamental reforms to the local taxation system.

28. Taken individually, such problems, while far from satisfactory, might be manageable for the Government, at least in the short term. But it would be altogether more difficult if they were all to coincide in certain sections of local government to form some sort of "flashpoint" in central/local relations. This might happen in inner city authorities.

29. Many inner city authorities are high spenders in the Government's terms and have proved largely unresponsive to RSG pressure. A majority of the local electorate do not pay full rates; many are dependent upon the local council for essential services, such as housing; and a sizeable proportion of them may also be council employees. The councillors serving such authorities often have close links with other parts of the public sector and/or public sector trade unions and have a high degree of political commitment. They therefore tend to place a high priority on maintaining services and jobs and will tend to pass on grant penalties to those who pay rates, rather than cutting spending. In this way they will present themselves increasingly as candidates for rate limitation.

30. It remains to be seen how councils of this type who have been selected for rate limitation respond; but at present those selected for 1985/86 are threatening to stand together and defy the policy in some way yet to be defined. If they take this position to an extreme - for example by failing to set an adequate rate to cover their expenditure - the Government could ultimately be obliged to put in commissioners to take over responsibility for running the councils' services.

31. Most inner city authorities will also be involved in the abolition exercise. If a full-scale confrontation were to develop over rate limitation these authorities may decide to withhold the co-operation which is necessary for the smooth implementation of abolition, particularly in inner London where there is not the desire among the boroughs (as there is among Metropolitan districts) to take over functions currently exercised by the upper tier. They may also refuse to participate as members of joint boards or may do so in an obstructive way.

32. It is therefore possible to envisage a situation in 1987 - one year after abolition and two years after the introduction of rate capping - where current policies combine to produce a crisis of confrontation in a handful of inner city authorities, particularly in inner London with commissioners attempting to run a number of inner city authorities. Such authorities would include Liverpool even though it is not on the rate limitation list as there is nothing to prevent any authority setting out to bankrupt itself. The problem would be compounded by the fact that such authorities could include some of the most run-down and deprived areas in the country - areas which the Government is committed to assisting through an urban programme currently running at its highest level since its inception. The Government would be portrayed as attacking communities most in need and the politics of the situation would quickly become polarised.

SCOPE FOR ACTION

33. If it is accepted that potentially serious problems may lie ahead on the basis of current policies, even if only

in certain limited sections of local government, the Government faces a choice: either it takes steps now to develop and articulate ways of avoiding problems which lie ahead; or it presses ahead with current policies mindful that problems may arise and prepared to trim and modify the policies as and when the problems materialise.

CONCLUSION

34. By 1987, the Government should have succeeded in implementing abolition and rate limitation and will be keeping up the pressure on local authority spending through the Rate Support Grant system. But these policies will by then have raised issues about the degree of central government involvement in local government affairs and the future role and concept of local government which will have repercussions for the central/local relationship and for the future development of local government policy. On optimistic assumptions, the policies may result in a set of manageable problems. On pessimistic assumptions, the policies may combine to produce some sort of crisis in central/local relationship in certain sections of local government, particularly the inner cities.

ANNEX A

December 1984:	Final 1985/86 RSG settlement details announced
April 1985:	First year of rate limitation begins
May 1985:	Non-metropolitan county council elections (metropolitan county and GLC elections suspended)
June/July 1985:	Main abolition bill receives Royal Assent
July/December 1985:	1986/87 RSG settlement announced
April 1986:	Abolition takes effect; joint boards' precepts and manpower controlled for three years from this date; some additional functions and reserve powers from Government Departments. Second year of rate limitation begins
May 1986:	Elections to London Boroughs (whole councils) to metropolitan districts (by thirds) and to some non-metropolitan districts by thirds)
July/December 1986:	1987/88 RSG settlement announced
April 1987:	Third year of rate limitation begins second year of joint board precept/manpower control begins
May 1987:	Elections to Metropolitan districts (by thirds) and to all non-metropolitan districts (some whole Councils, some by thirds)

July/December 1987:

1988/89 RSG settlement announced

April 1988:

Fourth year of rate limitation begins
third (and final) year of joint board
precept/manpower control begins

May 1988:

Elections to metropolitan districts
(by thirds) and to some non-metropolitan
districts (by thirds)

No later than June 1988:

General Election