CC NO.

PRIME MINISTER

RATE SUPPORT GRANT SETTLEMENT 1986/87: ENGLAND

E(LA) has now had four meetings under my chairmanship in an attempt to reach agreement about the future of targets and the public expenditure provision for local authority spending in 1986/87. I have also had two separate meetings with the Chief Secretary, Treasury and the Secretary of State for the Environment. Despite repeated attempts to reach agreement on a realistic and defensible settlement, I have to report with regret that I have been unable to resolve the differences that have emerged. We do, however, need early decisions if the main elements of the rate support grant settlement are to be announced in July. You have kindly agreed to chair a meeting of those of us primarily concerned tomorrow at 5.00 pm.

2. The issues that need to be decided are:

(a) whether or not targets should be retained (in addition to block grant pressures) as a control on local authority spending;

This cannot, however, be decided in isolation from:

(b) the overall provision for current expenditure by local authorities in 1986/87;

(c) the level of aggregate Exchequer Grant (AEG);

and consequently:

(d) what we judge to be an acceptable level of increase in rate poundages.

LORD PRESIDENT OF THE COUNCIL

## Whether to retain targets

3. In this year's settlement, Ministers promised that the Government would give serious consideration to the abandonment of targets and holdback for 1986/87. At E(LA)(85) 1st meeting, all members of the Committee agreed that targets should be abolished from 1986/87 if this could be done without unacceptable public expenditure cost. The Secretary of State for the Environment has argued subsequently that any reasonable public expenditure settlement can be achieved without targets, using block grant pressures alone; notably by increasing the rate at which grant is withdrawn for increases in expenditure and introducing thresholds at given levels of expenditure at which the rate of withdrawal becomes greater still. He has also argued that the information available is not adequate to construct robust targets for the joint boards and Borough and District Councils (the successor authorities) that will take over the functions of the Greater London Council (GLC) and Metropolitan County Councils (MCCs) from 1 April 1986. Consequently he believes there is a high risk that disregards will have to be granted, or court cases lost, or that the successor authorities will have to rate considerably in excess of their pre-abolition level. At best the Government will appear inept and unable to live up to its promises. It would be a self-inflicted wound.

4. The Chief Secretary, on the other hand, believes that the difficulties with the targets of successor authorities are over-stated and that there would be problems for only a small proportion of the GLC and MCC's expenditure which would not preclude workable targets being set. He is also sceptical of the ability of targetless regimes to deliver stated levels of expenditure; and it is arguable that to abolish targets

would give authorities the wrong spending signal. He has therefore proposed that targets should be retained with the important modification that no authority would have a target below its Grant Related Expenditure Assessment (the so-called GRE exemption). This means that the criticism of the low-spenders, many of whom are our friends, that targets prevent them from spending at their objectively assessed level of need (the GRE) would be defused.

5. We have had much discussion of these points. It is evident that there will be considerable difficulties in constructing targets for the successor authorities as the GLC and MCCs are not co-operating in giving DOE relevant information and some of it in any case does not exist. How serious these will be is very difficult to judge but clearly there is some risk of the consequences Patrick Jenkin fears.

6. There is then the question of the confidence we can have in regimes, either with or without targets, delivering predicted levels of expenditure. The DOE computer model is on largely untested ground both with targetless packages and with the GRE exemption. Peter Rees has argued that a targetless package must carry a greater risk of higher expenditure because while authorities spending below GRE will be exposed to much the same pressures under his or Patrick Jenkin's approach, authorities above GRE will be more severely constrained by targets and holdback if targets are retained. Patrick Jenkin does not accept this: he argues that his approach will still impose restraint on low-spenders (though more fairly than under a target regime) and a very tough regime on high-spenders, the most recalcitrant of which will be rate-capped in any event. Furthermore, he has argued that low-spending authorities are likely to spend appreciably more under Peter Rees' "targets with GRE exemption" approach as they will remember what happened

in 1983/84 when we re-introduced full targets below GRE, after a period of GRE exemption, in a way which benefitted those authorities which had not kept expenditure down. Peter believes that this risk could be reduced by a formal Government undertaking not to remove the exemption in a future year. Patrick believes that such an undertaking would be treated with some scepticism by local authorities.

7. There can be no certainty about what will happen. What we need to weigh up is the risk of a targetless regime failing to control expenditure effectively against the difficulties that retaining targets could create for us with the successor authorities in London and the metropolitan areas. In the end a majority of E(LA) believed that the risks of keeping targets were greater than those of abolishing them.

Public Expenditure

8. The latest estimate of local authority current expenditure relevant for rate suport grant in the current year is £22,203 million. The provision in this year's Public Expenditure White Paper (PEWP) for 1986/87 on a comparable basis is £21,750 million. This represents a real terms cut in current expenditure (assuming inflation of 4 1/2 per cent) of 6 1/2 per cent. In terms of total expenditure, the real terms cut is 3 1/2 per cent. We are all agreed that this figure is not realistic and that provision will have to be increased. By the end of our discussions Patrick Jenkin was advocating a settlement involving a predicted overspend of £670 million above PEWP levels. This would mean a reduction in real terms of 3 1/2 per cent in current expenditure (3/4 per cent in 'total' expenditure). Peter Rees did not feel able to go above £350 million overspend (a real terms reduction of 5 per cent in current expenditure; 2 per cent in 'total' expenditure). We were not able to bridge this gap.

9. There is obviously a limit to how large a real-terms cut can be achieved in a single year; the most ever achieved in the past for current expenditure is about 2 per cent, and on present predictions there will be a real terms standstill in 1985/86. I should add, moreover, that Keith Joseph indicated during our discussions that he would be looking for extra provision for education in 1986/87 of £600 million above PEWP levels, and Leon Brittan that he would be looking for an extra £170 million for the police. These sums, let alone what other service ministers may claim, cannot be accommodated even with the overspend advocated by Patrick Jenkin.

10. Of course if our PEWP plans are to be maintained overall, increased provision for expenditure by local authorities will need to be offset by savings in other services.

Aggregate Exchequer Grant

11. It is generally agreed that the level of total government grant to local authorities (Aggregate Exchequer Grant (AEG)) has very little effect on the level of expenditure. It is, of course, important in relation to the level of central government taxation. Futhermore, together with the level of expenditure, it is a major determinant of rates and we need to reach a decision about its quantum. The figure this year is £11,764 million which represents 48.7 per cent of total relevant local government spending. This was a reduction from £11,874 million and 51.9 per cent in 1984/5 in accordance with our policy of cutting the share of local government spending subsidised by the national tax payer in order to strengthen accountability.

12. It is common ground that AEG should not be increased in cash next year. This cash standstill will itself reduce the proportion of spending financed by about 2 per cent. (to 46.4) Peter Rees argues, however, that a cash standstill is equiv-

alent to a £500 million increase in net grant paid, since there would be no holdback without targets. He would therefore like to see a sizeable cash cut in AEG which would lower the percentage still further. (£750 million off AEG takes percentage to 45.5)

Implications for rates

13. Decisions on methodology (targets or not), public expenditure and AEG have direct implications for rates. The attached annexes contain the exemplifications we believe will be most useful to our discussion. They show the implications for rate poundages of:

(i) the package Peter Rees prefers (£350 million overspend*, with targets with GRE exemption);

(ii) a targetless package achieving the same overspend (£350 million*);

(iii) Patrick Jenkin's preference (£650 million overspend, targetless); and

(iv) a with-targets package achieving that overspend (£670 million).

Under each package the effect is shown of four different levels of AEG (cash standstill and reductions of £250 million, £500 million and £750 million). Any settlement we agree will need to involve defensible rate poundage increases. It will be particularly important, too, to make sure that rate increases are not excessive in the successor authorities, especially the Outer London Boroughs. If we failed to do so, rate increases would be attributed to the abolition of the GLC and MCCs and the wisdom of our abolition policy would come into serious question.

*For technical reasons, the exemplifications in the annexes are in fact based on overspend of £360 million.

LORD PRESIDENT OF THE COUNCIL

## Conclusion

14. I am sorry to trouble you with these inevitably complex issues. I would very much have preferred that it had not been necessary to do so. But time is now very pressing, especially if targets are retained, if all the necessary work is to be done for an announcement before Parliament rises in July.

15. I am sending copies of this minute to the members of E(LA) Committee, to the Chancellor of the Exchequer, the Chancellor of the Duchy of Lancaster, the Minister for Local Government, the Paymaster General and Sir Robert Armstrong.

bW

Privy Council Office
24 June 1985