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My ref:

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19 February 1986

*Am Miller*

## RATE SUPPORT GRANT 1986

E(LA) is meeting on 26 February to discuss the timing of decisions for the 1987/8 settlement and also to look at how information on the settlement might be best presented for decision taking. I am circulating separately papers by officials on those matters. Our discussions on the 1987/8 Settlement cannot get properly under way until we have some hard information about 1986/7 spending patterns in the Spring, but as I suggested in my letter of 27 January to the Chief Secretary I believe that it would be useful when we meet next week to exchange initial thoughts about the major issues in the next round and what we want to achieve. The remainder of this letter sets out some of my preliminary thoughts on these matters.

What we want to achieve, it seems to me, is a defensible settlement which meets attainable objectives for expenditure at reasonable cost to the ratepayer and taxpayer.

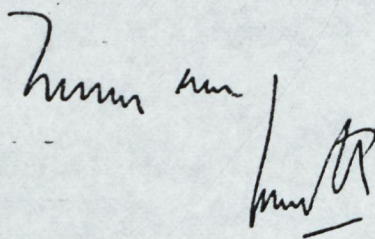
My first thought is that the approach we have adopted in recent years of using the PEWP figures for local authority current expenditure as a "signal" has run its course, at least in its present form. The simple fact is that the PEWP figures have now departed so far from reality that authorities no longer attach any real significance to them. Indeed it has become almost impossible to mount convincing arguments to support them, either at the global level or in terms of individual service provision. If we are to regain any credibility to influence local spending in the next round, I think we will need to be a good deal more realistic in setting levels of provision for 1987/8 and the later years of the Survey. The assumption in the 1986/7 Settlement of a 3½% increase in current expenditure was utterly unrealistic and has been the source of most of the criticism from our supporters. I hope it does not seem too paradoxical, but it seems to me that only by moving in the direction of realism will we be able to win the argument on local authority current expenditure restraint.

My second thought is that the crucial question is the quantity of grant and the percentage it represents of a realistic expenditure estimate. Our policy of reducing the grant percentage is now virtually at the point of driving significant authorities out of grant; when this happens the grant pressures we apply are of no relevance to those authorities. Secondly, reductions in the AEG percentage, exaggerated at block grant level by the steady increase in expenditure on specific grants, bear proportionately

harder on higher resource authorities. This is the intentional effect of resource equalisation. But it bears hard on authorities like many of the shire counties in the South-East and I simply do not think many of our supporters in the House, as well as in the authorities themselves, would regard further moves in this direction as acceptable or defensible. We may have reached the point already where such reductions are counter-productive. Because they force authorities into rate increases above what they regard as reasonable, such authorities then feel that they might as well be hung for a sheep as a lamb to the detriment of our expenditure objectives.

My third thought is that a major aim must be a settlement where what has happened can be readily explained and defended. In 1985 all this was greatly complicated by removing targets and coping with the effects of abolishing the GLC and met counties. This year no doubt we shall again be under significant pressures to change some of the GREs, and we shall also want to look at the other mechanisms in the system. But our aim of defensibility will be more easily achieved the fewer changes we make.

I am copying this letter to other members of E(LA) and to Sir Robert Armstrong.



KENNETH BAKER

PS: I have just seen the Chief Secretary's letter of 19 February, which I shall consider carefully.

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RSG SETTLEMENTS 1987-88

John MacGregor and Kenneth Baker are already squaring up for the RSG settlement in 1987-88. Kenneth Baker's letter raises three important issues.

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Realism

Coming new into this area, I have been amazed that the figures in the Public Expenditure White Paper are so far from reality. Last year's Survey took no view at all about 1987-88, so the cash figure for 1986-87 is just repeated. Both John MacGregor and Kenneth Baker want to get plausible figures. To get credible figures for 1987-88, we might have to take at least £3 billion out of the Reserve (of £6.25 billion) and allocate it to local authority programmes.

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The grant percentage

Kenneth Baker rightly points out that block grant is getting very low. This is because Aggregate Exchequer Grant (AEG) is being constrained. But the specific grants in it (eg police grant) are rising. This means that the remaining bit of the AEG - means-tested block grant - is being cut heavily. So the local authorities with high rateable values are losing out.

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But Kenneth Baker is trying to get an increase in AEG in two ways:

- (a) Increasing the total expenditure of which AEG is a fixed proportion. This pushes up AEG in absolute terms.
- (b) Increasing grant as a percentage of total expenditure.

If we do (a) we don't need (b) as well. We need a clear and simple framework for decision-taking. The best approach would be first to fix total grant in cash terms. The second stage is to decide how to divide up that cake between authorities.

Avoiding a repeat of 1986-87

The DoE now forecast the following rate increases for 1986-87:

Shires	20%
Mets outside London	10-15%
London	0- 5%
England (weighted ave.)	12-16%

If anything, these figures are optimistically low.

The 1986-87 Settlement turned out badly because so many levers were pulled to help London that Ministers ended up delivering far more assistance than they intended. It is obviously important that the implications of decisions for 1987-88 are more clear. After all, it is the rates for 1987-88 on which the General Election is likely to be fought.

*David Willetts*  
DAVID WILLETTS

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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Kenneth Baker MP  
 Secretary of State for the Environment  
 Department of the Environment  
 2 Marsham Street  
 London  
 SW1P 3EB

18 February 1986

*Dear Kenneth,*

**RSG SETTLEMENTS 1987-88**

*Will discuss in discussion*

Thank you for your letter of 27 January. I have seen comments from Malcolm Rifkind (30 January), Keith Joseph (3 February) and Douglas Hurd (4 February). I am glad that you all broadly share my views about the procedures we should adopt for the 1987-88 settlements. I look forward to consideration of these issues shortly in E(LA) when you bring forward firm proposals following recent discussions amongst officials.

You suggest we might also have a preliminary look at the issues of substance, a point which Keith and Douglas develop. I agree with this, and it may be helpful if I sketch out my general approach.

We have made no decisions on provision for LA current spending in 1987-88 and 1988-89. The figures in Cmnd 9702 simply repeat those for 1986-87, and we have said that we will take decisions in the 1986 Survey in the light of LA's budgets for 1986-87 and other factors. The Reserve for the two years (£6½ billion and £8 billion) takes this into account.

It is already clear that LA spending in 1986-87 will be well in excess of our plans. The prospects for 1987-88 are similarly sombre. Pay accounts for about three-quarters of local authority costs and there will continue to be strong upward pressure on settlements as well as reluctance on the part of local authorities to offset them by reductions in LA manpower, though there is no doubt that there would be scope for that.

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The Reserve for 1987-88 in our public expenditure plans may look large at £6¼ billion; but increased provision required for local authorities is likely to absorb the whole of the allocations that can be made from the Reserve as plans are rolled forward, and perhaps more. That will drastically limit our room for manoeuvre on the rest of public spending. The faster that local authority current spending rises, the more we shall have to look for savings from other programmes (including both central government programmes and local authority capital).

We must therefore do our utmost to reduce the upward pressure on local authority expenditure, with an eye particularly on those measures which might begin to yield results in 1987-88. There are several possibilities here, which I would like to discuss at E(LA). I summarise them here, necessarily in bald terms.

- (i) We should indicate to local authorities (and to the public) what level of spending by them will be compatible with our policy of holding public expenditure as a whole broadly constant in real terms. If our figures are realistic, we may regain their co-operation.
- (ii) To this end it is particularly important that they should hold their annual pay settlements - including even those at present indexed to earnings elsewhere - as close as possible to the forecast movements of the GDP deflator. We must try to persuade them to accept that recruitment, retention and affordability are what matter.
- (iii) We should assist LAs, in the interests of their ratepayers, to improve their efficiency and to examine critically whether increased inputs into services necessarily mean better quality or greater outputs. The Audit Commission has made some useful suggestions, identifying upwards of £1 billion of savings which local authorities have scarcely begun to realise. We should ensure authorities follow these up vigorously and there are many other areas in which we can promote existing policies with more vigour. Keith Joseph expressed this very clearly in his winding-up speech on the ILEA precept on 10 February, when he said "Spending is extremely important, but it is not the same as quality or effectiveness" (Col. 754).
- (iv) A related possibility is to find ways of reducing urgently the existing burdens, some of them statutory but outdated, which Central Government has placed on LAs. I know that William Waldegrave is already considering how best to tackle this, with a view to bringing proposals to colleagues. We need to pursue this exercise urgently and radically.

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- (v) We should also press the case for competitive tendering for appropriate services even before the Local Government Bill which you have proposed for the next Session can reach the statute book. I am glad to see that Michael Ancram, in his letter of 10 February, has endorsed the suggestion in my letter of 4 February to you for a White Paper on this in the Summer.
- (vi) Finally, in our impending review of LA charges we should consider what contribution they can make to a reduction in net expenditure. In work carried out in preparation for the Green Paper, your department noted that £¼ billion would be saved simply by all local authorities raising their charges to the average level. And there are many possibilities for going further, as foreshadowed by the Green Paper which referred to the further benefits "in terms of efficiency and accountability" which charging would bring. Some existing statutory prohibitions and Government controls on charges should be removed and we should consider whether, in return for removing central government controls over the levels of charges, we should oblige local authorities to levy charges for a wider range of services.

Some of these measures will be controversial; some will require legislation; and most will only take effect gradually. But if we are not to accept passively the large and growing threat from LA spending to our plans, we must make all possible efforts - if possible with their co-operation and with public support - to reduce it.

To reinforce these efforts we shall need tough RSG Settlements for 1987-88. We shall have to make full use of block grant pressures (the threshold, the slope of the poundage schedule and the nets and caps) and of selective rate-capping, and of their counterparts in Scotland. And - in accordance with what you have called "the central theme" of your Green Paper - we must drive home the need for greater local accountability by continuing our rigorous restraint on grant. To judge from the way in which the rate of growth in LA current expenditure has declined sharply since 1979 (Cmnd 9714 paragraph 1.25) as we have reduced grant, this has been much the most effective weapon at our disposal at least in the short term.

As I have said, there would clearly be some advantages in setting more realistic provision for local authorities, though we must not overlook the dangers of giving the wrong signals to them or to their employees. This is an issue we shall have to look at carefully in E(LA). One possibility would be to re-invent an "unallocated margin" to represent the difference between what we think should be spent and what LAs are likely to spend, so that not all of any increase in provision was allocated to individual services. This would also help to maximise the pressures via the block grant system.

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Over the period between now and July, I believe that we have to look very seriously at these suggestions, and any that other colleagues may have. We can ask William Waldegrave to report to us on removing tasks from local authorities and Angela Rumbold's group to consider the suggestions on charges. I suggest that we should ask officials to examine the other proposals in this letter, and any others which may make an impact on the problem, and report back to us by the end of April.

I am sending copies of this letter to the Prime Minister, Willie Whitelaw, the other members of E(LA) and Sir Robert Armstrong.

*Yours etc,*

*Jh*

JOHN MacGREGOR



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