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PRIME MINISTER

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LOCAL GOVERNMENT FINANCE

Ministers at E(LA) have begun squaring up for the 1987-88 RSG Settlement. You might find it helpful to have a progress report.

Provision for Local Authority Spending

Ministers agree that the provision for local authority spending in the White Paper needs to be more realistic (unfortunately, that means bigger). The DoE argue that, especially with so many authorities out of Conservative control, the figure in the White Paper has lost any effectiveness as a signal. The Treasury don't want to go quite so far, as a figure which is too big would legitimise local authorities' wilder spending plans, so they still want to salt away some money in the Reserve rather than have it all on show.

The range of disagreement is already narrowing, and the argument is focusing on a provision in the range £24.9bn-£25.4bn - an increase on provision in the current White Paper of between £2.7bn and £3.2bn. The figures in more detail look like this:



<u>Provision</u>				
<u>1986-87</u>		<u>1987-88</u>		
Settlement	Budgets	No Real		
		Treasury	Growth	DoE
		Option	Option	Option
£22.3bn	£24.2bn	<u>£24.9bn</u>	<u>£25.2bn</u>	<u>£25.4bn</u>
Percentage Change on		+2.75%	+3.75%	+4.75%
1986-87 Budgets				
(NB: GDP deflator = 3.75%)				
Change in existing		+£2.7bn	+£3.0bn	+£3.2bn
White Paper provision		<u>          </u>	<u>          </u>	<u>          </u>

### Aggregate Exchequer Grant

Here the Departments are further apart. The AEG percentage was set at 46.4% of the total fixed in last year's White Paper. The DoE want to stick to this percentage this year. If we do so, and at the same time increase total provision to, say, £25.4bn, that leaves an AEG of £13.1bn (as against £11.8bn this year).

Assuming that local authorities spend as much next year in real terms as they are actually planning to spend this year, an AEG of £13bn means a 5% increase in rates, on average. An AEG of £12bn (the Treasury's end of the range) would mean an 11% increase in rates on the same assumption. The gap is roughly equal to 1p of income tax. In the last resort, the



Treasury would rather that rates went up than that tax cuts were jeopardised. The DoE - or at least Kenneth Baker, when he was there - argue that holding rate rises is politically more important than tax cuts.

### Controlling Local Authority Expenditure

Ministers are also trying to find new and better ways of controlling total local authority expenditure. Three main options are being looked at.

### Beneficial Recycling

This is Nicholas Ridley's first new piece of jargon since becoming Secretary of State. His idea is very attractive in principle. He argues that the current arrangement for close-ending and then recycling grant - which was employed this year after the cases of Sefton, Bury and Wirral was brought to your attention - is not as effective as it might be. In particular, it doesn't discriminate enough between the good boys and the bad boys. He wants to change the formula so that more of the recycled grant goes to low spenders, and less to high spenders - "beneficial recycling". Unfortunately, there seem to be three practical problems with this:

- i. Grant recycling takes place in about February - often after local authorities have fixed their budgets for the coming year. So even if Nicholas Ridley's device could



be set up in time, it might not be very effective for  
1987-88.

- ii. Everyone is agreed that the distribution of grant needs to be handled with more sensitivity this year. But we cannot be sure of exactly what pattern of distribution would follow from beneficial recycling. There might be some unpalatable effects.

- iii. Legislation would probably be needed.

#### Abolish Recycling Altogether

This is the Treasury's counter proposal. The money which we take off local authorities from close-ending should not be recycled back to them at all. On its own, this would probably be too Draconian to be acceptable to the House, but the Treasury say that gross grant would be increased somewhat so that net grant after the abolition of recycling would not be too much lower. This proposal has its attractions. It enables the Government to appear generous in the gross total of Exchequer grant which is fixed. Secondly, it significantly steepens the penalty of marginal loss of grant for higher spending.

The drawbacks of the idea is that it would also require legislation, and its effects may be unpredictable and severe.



Officials are investigating both of these options at the moment for E(LA).

#### More Rate-Capping

Twelve local authorities have been rate-capped for 1986-87. E(LA) is moving towards rate-capping rather more authorities for 1987-88, but there is dispute on how far to go. The DoE are talking of about 18; the Treasury are aiming at something like 30. You may in due course want to give the Treasury strong backing. The difficulty in going much beyond 30 is that there would be increasing risk of successful legal challenge.

#### Conclusion

There is no need for any action at the moment, but the prospect of a big increase in local authority expenditure represents a major threat in the coming PESC round.

*David Willetts*

DAVID WILLETTS