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P.0984

PRIME MINISTER

The Financing of Education:

E(LF)(83)4 and 5

BACKGROUND

A At their last meeting (E(LF)(83)1st Meeting) the Sub-Committee decided that the most promising way of preventing rates from increasing beyond their present level was to redefine the respective responsibilities of central and local government. They accordingly commissioned further work on a scheme with the following main features:

- (a) transfer financial responsibility for teachers salaries from local to central government;
- (b) require local authorities to reduce their rate calls correspondingly;
- (c) restrict rate increases from this reduced base by some appropriate formula;
- (d) in the longer term, introduce a local tax on expenditure;
- (e) (probably) continued central control over local authority expenditure or the maximum level of local taxation.

2. Items (b) to (e) are under study by officials. But Item (a) is of fundamental importance: until it is confirmed or replaced, the detailed work by officials rests on a shaky foundation. The Secretary of State for Education and Science, in consultation with the other Ministers concerned, was accordingly invited to circulate a paper to the Sub-Committee: E(LF)(83)4 is his response.

B 3. E(LF)(83)4 considers four possibilities:

- (i) transfer school teachers pay to central government;
- (ii) transfer all or most local authority expenditure on education to central government;



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- (iii) introduce a separate block grant for education at a high rate;
- (iv) introduce a radical voucher scheme for schools, thus transferring most schools' costs to central government.

Since consideration of education vouchers is taking place elsewhere the memorandum concentrates on the other options. It argues that the first two options would entail excessive involvement by central government in education, and that the third option should therefore be chosen. In more detail, there should be a new education block grant, including mechanisms to encourage local authorities to bring their education expenditure into line with the Government's assessment of need. If paid at 75 per cent of planned expenditure it would allow rates to be reduced by an average of one quarter. The broad lines correspond to those of the proposal considered and rejected by the Ministerial Group on Local Government Organisation Finance (MISC 79) (MISC 79(82)5; MISC 79(82)3rd Meeting).

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E 4. The memorandum by the Secretary of State for the Environment (E(LF)(83)5) argues that the proposals in E(LF)(83)4 do not achieve the aim set by the Sub-Committee. In his view, they do not redefine the responsibilities of central and local government: they merely increase the proportion of Exchequer financing of local expenditure; and that can be done better by increasing the rate support grant (RSG) percentage.

F 5. Finally, the Chief Secretary, Treasury has circulated a memorandum (E(LF)(83)6) giving illustrative examples of the increases in central taxation needed to replace part of the local rates, or the growth in them. The figures are relevant background to the whole of the Sub-Committee's work, and not only the present issues.

MAIN ISSUES

6. The Sub-Committee is not being asked to take final decisions, but to establish the basis for further work. You will probably wish at this stage to leave on one side an approach based on education vouchers; since a radical approach has now been ruled out, any changes on that front are not likely to make a major change in local authority expenditure. The main issues before the Sub-Committee are therefore:

- (i) should one of the first three options in E(LF)(83)4 be adopted?

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(ii) alternatively, would an increase in the RSG percentage, probably coupled with a system of central control of local authority current expenditure, be preferable?

(iii) if none of these approaches is satisfactory, is there a better one?

Objectives

7. You will wish to keep in the foreground of the Sub-Committee's discussion the question 'What is the object of the exercise?' As E(LF)(83)5 brings out, the options fall into two distinct categories.

Category 1:

Options (i) and (ii) in E(LF)(83)4 transfer responsibility for a large element of local authority current expenditure to central government. Central government then itself controls the size of that element. Central government may also wish to control the remaining elements of local authority expenditure in order to ensure that total public expenditure does not increase. But the control problem is likely to be smaller than it is now because the total of expenditure for which local authorities are responsible is smaller.

Category 2:

Option (iii), like a simple increase in the RSG percentage, leaves responsibilities unchanged but increases the Exchequer contribution to local authority expenditure. The problems of controlling local authority expenditure are therefore likely to be greater than now. Moreover, option (iii), which introduces a new Exchequer grant, means that if central government wishes to control local authority expenditure it must devise two control systems, one for education, and one for other areas.

8. The educational arguments deployed in E(LF)(83)4 may also be relevant to the choice, as may such factors as relations between local and central government. But they are not the arguments which are immediately relevant to the present concerns of the Sub-Committee.

Transfer of responsibility for education expenditure

9. In considering the two options in this area you will wish the Sub-Committee to bear the following in mind.

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(a) Transferring responsibility for teachers' salaries would reduce local authority expenditure by an amount of the order of magnitude which the Sub-Committee thought appropriate at its last meeting. But to split responsibility for the costs of a service in this way would be almost certain to produce friction and inefficiency. As the Government has repeatedly pointed out, for example in the context of cash limits, there is a trade-off between labour and other costs; such trade-offs would be difficult to make if different authorities were responsible for labour and for other costs. Although it is not unknown for employers to link their pay rates to those set elsewhere, few if any accept that an outside body should be able to decide the pay, grading and numbers of their staff.

(b) Transferring the whole of education to central government would be more logical and efficient than splitting responsibility. It need not preclude local influence over decisions, as in the National Health Service. But it would entail a huge increase in the power of central government and a reduction in that of local government. This would raise political difficulties in itself. And it would call into question the future of the shire counties, since education is much the most important of their responsibilities.

Increase Exchequer Grants

10. In considering the two options in this area - introduce an education grant or increase RSG - you will wish the Sub-Committee to bear the following in mind.

(a) If an education grant was to lead to a reduction in the rates it would have to be paid at a higher percentage than the present RSG: E(LF)(83)4 suggests 75 per cent for England but the percentages would have to be even higher in Scotland and Wales. Except for reasons of education policy there is no reason why the Government should meet a higher proportion of education expenditure than other forms of local authority expenditure. And doing so would undoubtedly lead to pressures from other interest groups for equally generous grants towards the services with which they are concerned. The education policy objectives might be better met by more specific grants for particular purposes.

(b) As paragraph 9(iii) of E(LF)(83)4 brings out, one of the aims of an education grant would be to put pressure on low-spending authorities to increase



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their expenditure. It would therefore tend to increase the need to control local authority expenditure in order to avoid an increase in the total burden of rates and normal taxation.

(c) A particular problem is the ILEA, or whatever may replace it. The ILEA receives no RSG at present. It would be harder to defend a situation in which the largest education authority in the country received no education grant. If such a grant were conceded to ILEA, expenditure would be further increased.

As noted in paragraph 7 above, to introduce an education grant would require a double assessment and control system: one for education grant and one for RSG. The additional complexities would be great. The Sub-Committee may well take the view that the educational arguments need to be very strong to outweigh them.

11. The alternative approach of increasing RSG (and presumably strengthening central control over local authority expenditure) is undoubtedly the simplest of the options before the Sub-Committee. You will, however, wish the Sub-Committee to consider the following.

(d) It would be something of a reversal of past Government policy, which has reduced the RSG percentage. But this might be defended on the grounds that indirect influence through RSG and holdback has proved inadequate to prevent local authorities from unjustified increases in rates, and that the Government has therefore been forced to adopt a different approach.

(e) Ministers collectively have yet to be satisfied that a control system can be devised, even under the present RSG regime. This difficulty applies not only to the option of increasing the RSG percentage but also in a lesser degree to any of the other options which ease the financial burden on local authorities.

Possible alternatives

12. If the Sub-Committee do not favour any of the four options immediately before them, they may wish to consider whether it would be worth examining alternatives. It would not be productive to look for alternatives in the area of 'Category 2' (increased Exchequer grants), as the fundamental arguments will be unchanged. The only possibilities in 'Category 1' (transfer of responsibility) appear to be:



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local health and social services (expenditure of £2250 million in 1981-82 or 8 per cent of total revenue expenditure); or

police (expenditure of £2160 million in 1981-82 or 7 per cent of total revenue expenditure; but police expenditure already attracts specific grant (£970 million in 1981-82)).

National versus local taxation

13. E(LF)(83)6 illustrates the consequences for national taxes of holding down rates or increases in them. It provides useful background information for the Sub-Committee's work. But it is inherent in the Sub-Committee's present line in thinking that there will be some transfer from local to national taxation, at least in the short term: it is not likely to be feasible to control local authority expenditure tightly enough to avoid increases in rates without such a transfer. The question is how much loading on the national taxation is tolerable. Freezing rates at their 1983-84 levels would mean (assuming a 5 per cent a year increase in local authority expenditure in cash terms) extra national taxation of about £1.3 billion each year which is equivalent to 1½p on the basic rate or 2p on VAT. Is this tolerable? If not, would it be better to adopt a less ambitious objective of restraining the increase in rates in real terms eg an annual increase one or two per cent less than inflation.

HANDLING

14. You will wish the Secretary of State for Education and Science to introduce his memorandum, and the Secretary of State for the Environment to reply on the basis of his own. The Secretaries of State for Scotland and Wales could then be asked to comment from their dual standpoint as education and local government Ministers. The Chief Secretary, Treasury will no doubt wish to draw attention to the public expenditure implications.

CONCLUSIONS

15. You will wish the Sub-Committee to decide which of the following assumptions officials should take as the basis for their future work:

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- (a) transfer to central government of responsibility for school teachers' pay;
or
- (b) transfer to central government of responsibility for all local education
expenditure; or
- (c) introduction of an education block grant, probably at a rate of about
75 per cent in England; or
- (d) increase in RSG percentage, probably coupled with some form of direct
control of local authority current expenditure; or
- (e) some alternative.

16. You may also wish to Sub-Committee to give guidance to officials on how much
loading on to national taxation would be tolerable.

PL

P L GREGSON

11 March 1983

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EDUCATION



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10 DOWNING STREET

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Prime Minister

It will help Terry Heiser
 enormously in the preparation of
his paper if the ground on
education could be cleared by
 a discussion of the attached paper
 on financing education - E(LF)(83)

Agree to a meeting of

E(LF) on this?

Yes
 No

MCS 3/3

Told Cab Office