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P 02798

PRIME MINISTER

LOCAL AUTHORITY NEEDS ASSESSMENT

[E(LF)(87)34]

DECISIONS

The Sub-Committee need to decide on the broad principles (but not at this stage the details) for assessing local authorities' expenditure needs for the purposes of the new grant system. The main issues are:-

- i. whether needs should be assessed for each individual authority or only at taxpayer level for each area;
- ii. whether there should be separate needs assessments for each major service or just one assessment covering all services;
- iii. where the balance should be struck between simplification on the one hand and the need to reflect the realities of complex services on the other.

In the light of decisions on these issues, you will want to decide whether to confirm your earlier agreement in principle that the new grant should be paid at taxpayer level in England and not to each tier of authority in an area: this point must be settled before the Recess, so that work can proceed on drafting the Bill.

BACKGROUND

2. Equalisation of spending needs has been a feature of Exchequer grant to local authorities since 1929. Successive grant systems



have required a method of assessing what different authorities need to spend to provide a common level of service. In the 1970s, a fairly simple formula was used to measure total needs in each area (not for the separate tiers), based on a number of objective indicators such as pupil numbers and population. The relevant indicators were selected, and weights attributed to them, using a statistical technique (multiple regression analysis) to explain variations in actual expenditure. This approach was criticised, particularly by the then Conservative Opposition, on two main grounds: first, that the formula was an incomprehensible "black box", which no-one could relate to actual services; and second that high spending by authorities with particular characteristics (e.g. urban authorities) could feed back into high needs assessments, whether or not that spending was justified.

3. The grant related expenditure (GRE) system was designed to respond to these criticisms. Separate GREs were calculated for each main service (e.g. education, social services) on the basis of formulae based as far as possible on independent evidence or judgements about which factors influenced needs, and what weights should be attached to them. Each individual authority received the sum of the GREs for the services it provided. This approach overcame some of the criticisms of the previous approach. But it too has been criticised for being too complex, incomprehensible and unstable.

4. The Green Paper "Paying for Local Government" recognised the validity of these criticisms. It said -

"... the Government intends to review the existing formula (for GREs) before the new grant system comes into operation, with a view to making it less complex and more stable (paragraph 4.36)."

At the sametime the Green Paper clearly envisaged a system similar to the existing GREs, albeit with substantial simplification, since it also said:-



"The introduction of GREs marked a big step forward. For the first time, an attempt was made to use a client group/unit cost approach to assess needs for the main services (Annex H, paragraph 11)" and,

"The needs grant system now proposed will continue to be based on the client group/unit cost approach developed under the present GRE system." (Annex H, paragraph 12).

5. The Chancellor of the Exchequer, however, wrote to Mr Ridley on 16 June proposing a return to a single very simple formula covering the full range of local authority services. He suggested that a formula with only about 7 indicators could reproduce most of the variations in needs as measured by existing GREs.

#### MR RIDLEY'S PAPER

6. The note by officials attached to Mr Ridley's memorandum discusses three possible approaches to assessing needs under the new grant system:-

a. option 1, based on a single simple formula of the sort proposed by the Chancellor, derived by regression analysis against existing GRE's (not actual spending);

b. option 2, retaining separate assessments for the major services (education, social services, police, fire and transport) but with minor services grouped into a single block. There would be 15 separate components, compared to 63 at present;

c. option 3, based more closely on existing GREs but with some limited simplification.

7. Illustrative figures for the possible effects of each option (2 variants of option 2) on community charges are given in Table 1 to the note. They suggest that:-

- option 1 would tend to understate the needs of inner urban areas as compared with existing GREs, leading to even higher community charges than you have previously seen - e.g. £1,031 in Camden;
- option 2 could provide a range of figures, either better or worse for the inner cities than existing GREs, depending on detailed decisions about the simplified formula.
- Option 3 could of course also be adjusted to produce more or less favourable results for the cities.

8. You will want to note these indications, but you should treat them with great caution. A different approach to option 1 might well give entirely different results. Furthermore, while either option 2 or option 3 can clearly be adjusted to produce a particular result, it is not clear that the implications for services would be acceptable to the responsible Ministers, or to the Government as a whole.

9. In his covering Memorandum, Mr Ridley asks E(LF) to agree that new simplified needs assessments should meet the following criteria -

- a. there should be separate assessments for individual authorities. He suggests this is essential if community charge payers are to be able to judge their authorities' spending policies, and therefore for accountability;
- b. there should be separate assessments for the major services. If there is an assessment for each authority, that means separate assessments for police, fire, education and public transport joint boards in London and metropolitan areas. That leads naturally to separate assessments for these services throughout the country. Mr Ridley also suggests that it will allow better assessments of need for the key services;



c. there should be the minimum number of components and indicators consistent with a. and b. above.

In practice, these criteria lead directly to option 2 (Mr Ridley's preferred choice) in the note by officials.

#### VIEWS OF OTHER MINISTERS

10. The Chancellor of the Exchequer will probably accept that the new system requires needs assessments for each individual authority if accountability is to work. But he is likely to resist assessments for individual services: he may argue that these serve no useful purpose, and provide much ammunition for the opponents of Government policies on e.g. education. These arguments would point to a development of option 1, but with a simple formula for each tier of local authorities.

11. Service Ministers are likely to take a variety of approaches. The Education Secretary and the Social Services Secretary are likely to want to retain separate needs assessments for their services, as important signals about the correct level of service provision. They will also wish to retain flexibility to adjust the formulae to reflect policy priorities. (Both Ministers reserved their position on the question of paying the grant at taxpayer level: I understand they will be content to agree to that so long as they can keep their own needs assessment formulae). Other service Ministers, for example the Home Secretary and the Transport Secretary may feel that service needs assessments are more often an embarrassment than a help in presenting Government policy. They might be happy to see service assessments abandoned. The Secretary of State for Wales will probably argue that the separate GREs for Wales are already very close to option 2 in Mr Ridley's paper, and that no substantial simplification is needed.

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## MAIN ISSUES

Assessments for individual authorities

12. You have agreed in principle that grant should be paid at taxpayer level, not to individual authorities. Given that decision, there are substantial presentational attractions in the idea of also calculating needs assessments only at taxpayer level. This would certainly allow very substantial simplification. In particular it would circumvent entirely the problem of "concurrent services" (services which can be provided by both tiers of authority in shire areas). But such a system suffers from the crucial drawback that there would be no way for community charge payers to tell which tier was responsible for their particularly high or low charge. This would destroy accountability. For that reason, the national community charge bills you considered at the earlier meeting all assumed that needs would be assessed for each authority individually. You will probably want to agree that needs assessments should be made for each authority, not just at taxpayer level.

Assessments for individual services

13. The arguments for and against separate assessments of need for major services are less conclusive. In favour of separate assessments -

i. they were presented by the Government as one of the major improvements in the present system. The Green Paper clearly envisaged that they would continue;

ii. they allow a more comprehensible approach to assessing needs, and provide more scope for sensible judgements about needs. It is easier to explain that e.g. education GRE is based on the number of pupils and the unit cost of educating them, than to justify a formula which applies across a range of services;



ii. they probably produce better and more consistent assessments. For example, the need for spending on education would be assessed on the same basis everywhere. This might not be the case if there was one simple formula for the needs of shire counties, another for those of metropolitan districts, a third for outer London boroughs and a fourth for the ILEA.

14. On the other hand:-

iv. they lead to more complexity in the needs assessments formula;

v. they can be used by local authorities and service pressure groups to attack Government policies;

vi. they increase instability, because there is always a temptation to alter them annually in response to criticism or to reflect new policies.

15. The balance between these arguments is far from clear. But you may feel that it would be difficult for the Government to disown the statements it made when the present RSG system was introduced, and repeated in the Green Paper, in favour of service needs assessments. That would argue in favour of needs assessments for the small number of major services, as under option 2.

#### Level of simplification

16. It is common ground that the existing GRE system has become much too complex. It has also been altered too often, leading to damaging instability. You will probably want to agree with Mr Ridley's aim of the smallest number of separate assessments and indicators consistent with your other decisions. If you accepted a modified option 1, without service assessments, that might mean a simple formula for each tier of authority (perhaps 7-9 formulae in all, depending how the ILEA was dealt with) each with up to 7



indicators. On option 2 it might mean 15 formulae for different services, many with only 1 or 2 indicators, but some (e.g. for in practice social services) with rather more. This suggests that there might be relatively little difference in complexity between the two options. Both would certainly be much simpler than current GREs (63 components and over 60 indicators).

#### Further work

17. As Mr Ridley says, you do not need to take a final or detailed decision now. But if you can agree on the broad principles of the new system, you will want to ask Mr Ridley to produce further detailed proposals for consideration later.

#### Payment of grant at taxpayer level

18. E(LF) should also consider whether to confirm its decision in principle to pay grant at taxpayer level in England. If you agree to retain separate needs assessments for the main services, the Ministers who reserved their position earlier can be expected to go along with that.

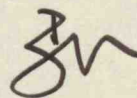
#### **TIMING**

19. Decisions on the needs assessments themselves are not needed for the legislation, which can be drafted in enabling terms. But you do need to confirm before the summer break your provisional agreement that grant should be paid at taxpayer level so that it can be reflected in the Bill.

#### **HANDLING**

20. You will want to ask the Environment Secretary to introduce his paper. The Chancellor of the Exchequer and the Secretaries of State for Education and Social Services will certainly wish to speak. Other service Ministers and the Secretary of State for Wales will probably wish to comment.

22 July 1987  
Cabinet Office

  
J B UNWIN



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PRIME MINISTER

22 July 1987

LOCAL AUTHORITY NEEDS ASSESSMENT

You are to discuss Mr Ridley's proposals for simplifying the needs assessment used in distributing grant to local authorities. The choice is between maintaining but simplifying the approach in the present GRE system and a more radical approach put forward by the Treasury.

Background

The essence of the present approach is to build up an assessment of what each local authority needs to spend from assessments for each of the major services it provides. This approach is popular with service departments because it provides scope to 'talk up' the need for spending on 'their' service and a cottage industry for statisticians in working out the precise formulae. Service Ministers may be more equivocal about it because it also provides scope for local authorities to argue that this or that service is under represented in the GRE.

The justification of continuing a service based approach

Mr Ridley argues that a service based approach is needed in order to promote accountability. Chargepayers should be able to compare the gross charge levied by each of the local authorities levying a charge on them with a needs assessment for that authority in order to determine whether it is over-spending or not.

At first sight these arguments are persuasive since if accountability is to work chargepayers certainly need objective evidence about the performance of their local authority. But it is questionable whether needs assessments determined by Whitehall will be seen in this light. Local

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authorities may well argue that the assessments are arbitrary and bear little relationship to needs in their area.

An alternative approach is to rely on comparisons of performance with the average or minimum level of expenditure for other local authorities of the same type. This information would be incontestable and would exert downward pressure on the highest spending authorities. There may be practical objections that this information will not be available at the time Community Charge Bills are sent out. This could be overcome by requiring charges to be fixed by, say, the second week in March.

## The Treasury Approach

Since needs assessments are not required for individual local authorities, they are not required for individual services because the justification for service assessments rests on the existence of single service authorities. The Treasury approach can therefore be pursued without compromising accountability. It involves a simple calculation of need at chargepayer level based on six indicators (population density, number of children, number of under-fives, number of over-65s, miles of road and a 'social indicator').

It has the following advantages:

1. It is readily intelligible to the man in the street. (eg it includes spending of £695 a year for each schoolchild).
2. It would remain stable for relatively long periods. The amounts allowed for each indicator would be up-rated each year but the relative size could remain stable for, say, 5 years at a time. Periodically it would be



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necessary to reconsider the relative sizes of the amounts.

3. This would make it much easier to predict the effects on the Community Charge of particular levels of total expenditure on grant.
4. It would no longer be possible for service Departments to 'talk up' the needs assessment for their service.
5. It would do away with the cottage industry that has grown up around GREs.
6. Service Ministers would no longer be faced with representations about the GRE's for which they are responsible. This pressure is likely gradually to make even simplified GRE's more complex as time goes on.

Against, there are some disadvantages:

1. It would increase the eventual level of the Community Charge in inner London and in some higher spending areas outside London, such as Liverpool. But because the DoE has not taken the approach seriously, it still has some rough edges. With some modification it should be possible to reduce this effect, for example by increasing the weight given to the 'social indicator'.
2. It will be unpopular with the local authority associations who will argue that this approach is less 'fair'. Of course, they are major participants in the cottage industry spawned by the present system. But the local authority treasurers I have spoken to say they pay little attention to the detailed structure of the present formula and would welcome greater simplicity and stability.

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## Alternatives

The Treasury approach should now be fully developed by the DoE and Treasury to iron out these difficulties. Provided this proves possible, it should be adopted. Otherwise, we favour the simplest of the alternatives offered by the DoE. This has individual assessments for the major services but a population based formula for other services.

## Conclusion

The Treasury proposal for radically simplified needs assessments has much to commend it. The major objection, that it does not promote accountability because it cannot provide needs assessments for individual authorities, is not valid. These assessments would in any case be open to attack by local authorities so it is unclear how much weight electors will place on them. A more convincing and objective approach is to require local authorities to compare their level of expenditure with the best or the average in their class.

The main advantage of the Treasury approach is that it strips out the mystique of the present grants system and produces comprehensible and stable assessments of need. At the moment, it would increase the level of the Community Charge in high spending areas which will make the transition more difficult. The formula should therefore be refined to minimise these difficulties so that Ministers can take a final decision on the basis of fully worked up figures for this option and the simplest of the options put forward by the DoE.

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