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PRIME MINISTER

LOCAL AUTHORITY GRANT SETTLEMENT 1989

We are meeting for a preliminary discussion about prospects for the grant settlement on 25 May. It may be helpful to set out some initial figures and a range of options, which I have discussed with John Major.

The settlement this year will be particularly important and difficult. We must aim for sufficient grant and a pattern of distribution that will ensure that community charges in the first year can (or could be) set at reasonable levels. But we must recognise that some of the authorities may try to use the introduction of the new system as cover to push up spending levels and blame the resulting high community charge levels on the Government; this points to keeping grant levels down so as to discourage excessive spending.

I think myself that the right way to resolve this in the first year is to set a realistic level of grant which would enable sensible authorities to keep average community charges down to a reasonable level if they budget sensibly. It is essential that a number of the well run authorities should be able to achieve community charges at or below the national community charge for spending at need (CCSN). Otherwise our credibility will be lost. We always have the possibility of community charge capping for any authorities which abuse the position by pushing up their spending excessively. I say this with reluctance because it would be controversial and would diminish local accountability.

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The 1989 position.

The following table summarises the position for 1989/90.

	1988/89	1989/90	1989/90
	Outturn	Settlement	Budgets
Current Expenditure	£27,822m	£29,140m	£30,342m
% changes from 1988/89	-	4.7%	9.1%
AEG	£12,462m	£13,575m	£13,575m
% change from 1988/89	-	8.9%	8.9%

Provision in the settlement for 1989/90 was 4.8% above 1988/89 budgets (and 4.7% above out-turn). This allowed for 4% general increase in expenditure plus an extra £110M for community charge preparation costs. At this level of spend, the settlement would have allowed rate rises to be kept to only 2%. In the event the increase in local authority expenditure was 9.1%, including £207m for community charge preparation costs. Local authorities drew down balances and kept domestic rate increases to an average 9.3%.

The 1989 Round

Moving to 1990/91 we have two main decisions to make at the aggregate level and announce in July

- (i) the total of need to spend
- (ii) aggregate Exchequer finance for authorities (AEF)
This is equal to needs grant (revenue support grant)
+ certain specific grants + non domestic rates.

The difference between those two figures will be the amount which authorities will have to raise from the community charge if they spend at need. This amount divided by the number of

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chargepayers (estimated at 36 million) will determine the level of the community charge for spending at need (CCSN). This will also be announced in July and in effect the Government will take responsibility for it. The table below shows the CCSN over the last three years; we shall want a CCSN for 1990/91 which looks reasonable. We must also consider what will happen to the community charge if they spend above "need" by varying amounts. I have also shown the average rate bill per adult; we shall want a likely average actual charge which does not seem unreasonable.

	1987/88	1988/89	1989/90	
			Soon to be published	Adjusted for changes in function eg. ring fencing etc
CCSN	178	<u>202</u>	<u>240</u>	227
Average rate bill per adult (equivalent to the average actual CC)	224	246	274	258

The Table at Annex A summarises the key figures for illustrative options which officials have constructed as an initial sighting shot. (Fuller details are given in Annex A). John Major favours Option A; I favour Option D. The options produce the following results:

- In Option A the need to spend increases by 7.5% above this year's GRE (that is 3.5% above the current forecast of the GDP deflator). AEF goes up by 4%, so it is constant in real terms. This produces a CCSN of £264. Actual average charges are in the range £300-321

NB
 The present inflation assumption is at 4%
 Recg.

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- In Option B the need to spend increases by 9.5% above this year's GREs. AEF goes up by 6%. The CCSN rises to £270 but actual average charges are somewhat lower at £289-£310. ~? Lyke
- In Option C the need to spend is 3% above this year's budgets rather than GREs. AEF goes up by 6.5%. The CCSN is £273 and actual average charges are £285-£306.
- In Option D the need to spend increases by 4% over this year's budget, plus an additional £200m for the extra costs of collecting the community charge. AEF increases by 9.3%, giving lower actual average charges of £270-£290.

Actual charges for all these options have been calculated on the basis of actual spending in the range £33.2 to £33.9 billion. This represents a cash increase of 4% to 7%, plus £200m for community charge collection costs, or around a real terms standstill to a real increase of 3%.

I set out here my views on how we should assess the options. John Major's views are below. I suggest the important thing at our first meeting is to take a view on:

- i. What is an acceptable and plausible level for us to determine the need to spend in 1990/91 in relation to the provision or needs we set in 1989/90, the budgets that have come through for that year, the scope for efficiency savings and pressures for additional service provision, such as the need to provide for the administration of the community charge itself. I myself think this could hardly be set lower than 3%

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above this year's budgets in cash terms (the Option C figures) and would prefer to see it higher to ensure that a reasonable number of well-run authorities can and will be at or below needs assessment. This is the crucial test in my opinion on which the success of the whole system hangs.

- ii. What is the level of spending by local authorities that is actually likely to come through in 1990/91 bearing in mind changing service needs, inflation, possible economies, reactions to the first year of the community charge, and the impact on authorities of different possible grant levels? However strong the pressures, I do not myself believe it would be realistic to expect authorities to spend less than 7% above this year's budgets. (Their 1989/90 budgets are themselves 9% above 1988/89 budgets).
- iii. What average levels of community charge we should be aiming at, both the standard level for spending at need, and the actual average charge that will emerge to finance actual levels of expenditure. I think that our objective should be to have a community charge for spending at need around £270. But we should have an eye to the likely average actual level of charges, which I think we should aim to keep below £300.

If we can take a view on acceptable levels for those three parameters the level of AEF needed to achieve the right results can then be calculated from them. I attach at Annex B a chart which may help to illustrate the different levels of AEF needed to achieve different levels of charge on various assumptions about the need to spend and the likely level of

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spend in practice. Of course, if the level of AEF which emerges from this process seems unreasonable, we will need to go back and reconsider our initial views on need to spend and charge levels.

John Major considers that it will be important to set challenging but realistic targets for local authorities on both need to spend and the CCSN. These are the spending and community charge figures for which central government takes responsibility: in particular he suggests that the need to spend should be set at a level that reinforces the downward pressure on LA spending - which has grown faster than other public spending in recent years. John also suggests that grant is crucial, since the lower the level of grant, the lower the level of spending which is likely to occur within the range shown in the Annex.

Accordingly he favours a need to spend total of a cash increase of 7.5% on the 1989-90 GREs (ie need to spend). This is a real increase of 3.5% on GREs which were themselves raised by 4% in real terms last year. He believes that this is sufficient to accommodate upward pressures on needs taking into account the scope for savings identified by the Audit Commission and savings from both the extension of competitive tendering and higher fees and charges. Under this option, AEF would be set at £22.3bn, maintaining Exchequer support to local authorities constant in real terms. This would be consistent with a CCSN a little lower than the range I propose. The CCSN would represent a marginally lower burden on the chargepayer.

For illustration, John has also suggested an option with a higher need to spend and more Exchequer support ie option B. AEF increases by 2% in real terms and is only a little below

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my lower option on AEF. He is concerned that such a real increase in grant to local authorities would convey the wrong message about spending to local authorities. The need to spend under this option is set at £32.4bn, an increase of some 5% in real terms. He believes there must be dangers - bearing in mind the experience in Scotland - that such a level of need to spend will become a target for many previous low-spending authorities and lever up total spending accordingly. The CCSN consistent with this option is £270. With a higher need to spend, the CCSN must be raised to the range I propose, if the burden is not to fall wholly on the taxpayer.

Other Issues

The main other issues that will have to be settled in the round are:

- i. the level and yield of the national non-domestic rate;
- ii. the new needs assessments, which will affect the distribution of grant in the medium term;
- iii. the details of the safety net which will be the key determinant of grant distribution in the first year.

Decisions on these will not be needed until September. However, we shall want to take a preliminary look at them in July, when I bring forward authority by authority exemplifications. We will want to be satisfied that the aggregates we settle on will give us an acceptable settlement whatever our final decisions in the Autumn on distributional issues.

Conclusion

The issue I think it would be most helpful to resolve at our meeting is whether the range of options shown in Annex A is the right range to put before colleagues in E(LF).

I am sending copies of this minute to Cecil Parkinson, John Major and Sir Robin Butler.

A handwritten signature in black ink, consisting of a stylized 'N' and 'R'.

NR

22 May 1989

OPTIONS

Option A

The need to spend figure has been derived by adding 7.5% to the need to spend figure for 1989/90.
AEF has been derived by adding 4% to the figure for 1989/90, ie a real terms standstill.

Option B

The need to spend figure has been derived by adding 9.5% to the need to spend figure for 1989/90.
AEF has been derived by adding 6% to the figure for 1989/90.

Option C

The need to spend figure has been derived by adding 3% to 1989/90 budgets.
AEF has been fixed so as to produce a CCSN of £273.

Option D

The need to spend figure has been derived by adding 4% + £200 million to 1989/90 budgets.
AEF has been fixed so as to produce a CCSN of £271.

AEF = needs grant + specific grants + Non-Domestic Rates.

Key figures for 1989/90 are: Need to spend (adjusted)	£29.6 billion
AEF (adjusted)	£21.4 billion
of which grants	£11.9 billion
CCSN published	£240
adjusted	£227
Actual spend (adjusted)	£31.7 billion
Average actual CC published	£274
adjusted	£258



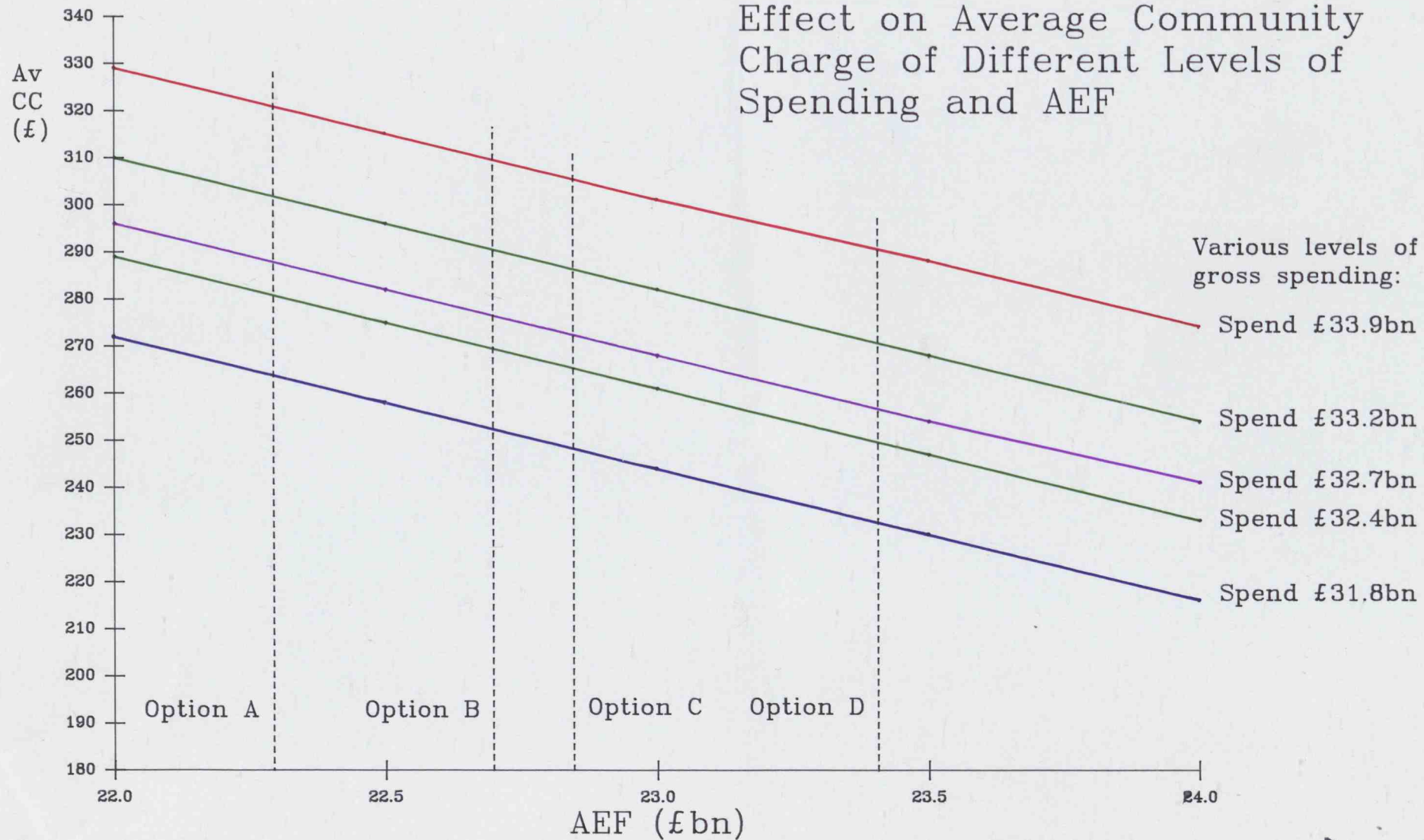
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LOCAL AUTHORITY CURRENT SETTLEMENT: POSSIBLE OPTIONS

OPTIONS		A	B	C	D
Need To Spend	£bn	31.8	32.4	32.7	33.2
AEF	£bn	22.3	22.7	22.8	23.4
Of Which Grants	£bn	11.8	12.2	12.3	12.9
Expenditure Falling On Chargepayers	£bn	9.5	9.7	9.8	9.8
CCSN	£	264	270	273	271
Range Of Likely Expenditure	£bn	33.2 - 33.9	33.2 - 33.9	33.2 - 33.9	33.2 - 33.9
Amount Falling on Chargepayers	£bn	10.8 - 11.6	10.4 - 11.2	10.3 - 11.0	9.7 - 10.4
Actual CCs	£	300 - 321	289 - 310	285 - 306	270 - 290
Memo Item:					
Increase in AEF	£bn	+0.9	+1.3	+1.4	+2.0

+

Effect on Average Community Charge of Different Levels of Spending and AEF





24/5

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My ref:

Your ref:

P R Gray Esq
PS/Prime Minister
10 Downing Street
LONDON SW1A 2AA

23 May 1989

Dear Paul,

LOCAL AUTHORITY GRANT SETTLEMENT 1989

I refer to my Secretary of State's minute of 22 May to the Prime Minister. Could you please substitute the attached for the cover sheet to the the table at Annex A. *with R?*

Copies of this letter and the revised cover sheet go to Stephen Haddrill (Energy), Caris Evans (Treasury), and Trevor Woolley (Cabinet Office).

Yours
A D Ring

A D RING
Private Secretary

*Done, and
original
destroyed.*

*Rec 6
24/5*