A

PRIME MINISTER P 03474

LOCAL GOVERNMENT FINANCE 1990-91

Letter from Secretary of State for the Environment of 16 June

1. Mr Ridley has reached agreement with Mr Major on a package covering this year's grant settlement and a new safety net for the community charge which, subject to your views, he would like to put to E(LF) next Thursday.

2. There are three central issues on which you may wish to concentrate:

i. **the grant settlement**. This is based on the two central options - options B and C- agreed at your preliminary meeting, but is slightly more generous. In particular it includes £200 million more grant from central Government, in part to assist Inner London Boroughs take over ILEA responsibilities. But the settlement is still considered by the two departmants to be tough. **You will wish to decide whether you are content**.

Losers -25 Remaining [illegible] by remaining gains

Gainers +20 plus ¼ of surplus

ii. **the safety net**. The new proposal is that all losers should bear the first £25 of their losses; that all gainers should keep the first £20 of their gains plus 25 per cent of any gains above that; and that all losses over £25 should be financed by the remaining 75 per cent of gains above £20. This is substantially different from the safety net agreed earlier. **You will wish to decide whether you are content or whether more work should be done on the implications of the new**

formula. Decisions are not scheduled until the autumn but the Treasury want it to be agreed now, as part of the grant settlement, that whatever form the safety net takes, it will be self-financing.

iii. **handling of E(LF)**. Most members of E(LF) will be coming to these issues completely fresh, with the service Ministers looking for a very much higher settlement, at least on the total of standard spending. Mr Ridley and Mr Major suggest that the best course is simply to table the package on which they have agreed and press the Committee to accept it. There would be nothing up their sleeves. **You will wish to consider the tactics**.

3. The immediate issue is whether you are content for Mr Ridley to put round his paper in its present form. **If you are content with the proposals on the grant settlement and tactics, you may wish to agree that he should**. The difficult issue of the safety net may take more time to settle and the meeting on Thursday could be used to have a first discussion of the the new formula. In agreeing to circulation of Mr Ridley's paper, you might wish to make it clear to him and Mr Major that you wanted to go through the implications of the new formula before deciding on it.

MAIN ISSUES

The grant settlement

4. At your meeting on 25 May it was decided that Mr Ridley, in consultation with Mr Major, should bring forward papers for E(LF) on the basis of two options, options B and C. The settlement which they have now agreed fulfils this but is slightly more generous. The figures are as follows.

	Option B	Option C	Now proposed
Total of standard spending	32.4	32.7	32.8
AEF	22.7	22.8	23
of which grants	12.2	12.3	12.5
Expenditure falling on chargepayers	9.7	9.8	9.8
CCSN	270	273	275
Actual CCs	289 to 310	285 to 306	280 to 301

5. This settlement has only been reached after a lot of discussion and with concessions on both sides. Mr Ridley in particular regards it as tough, much more so than in recent years, but is prepared to stick with it. **The main points which you may wish to note are as follows.**

i. **the total standard spending level** (previously known as the "need to spend") is £32.8 billion, a 3.3 per cent increase on current spending in local authority budgets for 1989-90. This is £100 million more than the old Option C for technical reasons to do with financing items. It is the figure which will particularly interest the service Ministers because it will have to be divided up into the various service components in the autumn. They are considering whether to circulate a joint paper for next week's meeting which will reportedly show that a total standard spending level of £34.5 billion is needed to accommodate their bids.

ii. **Aggregate Exchequer Finance** (AEF) is £23 billion rather than the £22.8 billion in the old Option C. The increase of £200 million would cover the technical financing changes and an extra £100 million to assist Inner London Boroughs taking over ILEA responsibilities.

iii. **The Community Charge for Standard Spending** (CCSS, previously the Community Charge for Spending at Need, CCSN) derived from these totals comes out at £275 per head. If agreed, this will be announced in July. Mr Ridley's paper shows however that if the actual budgets of local authorities next year were 7 per cent above their levels for this year, the average actual charge would be £301 per head.

iv. **The effect of the community charge on the RPI** could be statistically significant. We have not consulted departments but our own calculations suggest that an average actual charge of £301 compared with this year's average rate of £274 per adult could make a difference of around 0.4 per cent to the RPI; and there would also be an effect on index-linked public expenditure.

This is not a special RPI effect because we now have the CC rather than the rates; higher LA spending would produce a similar effect under the present system.

The safety net

6. Introduction of the Community Charge will lead to shifts in the burden of domestic taxation at two levels:

i. within each local authority area there will be shifts between individuals, with ratepayers tending to gain and non-householders tending to lose. Ministers have decided that these shifts should take place fully right from the start, without any transition;

ii. as between different areas the removal of domestic resource equalisation and the pooling of non-domestic rates will lead to large shifts in the overall tax burden on their residents taken together. Areas with high rateable values and low spending levels will tend to gain ("gainers"); those with low rateable values and high spending will tend to lose ("losers"). In addition there is the special case of London which, although it has high rateable values, has received favourable treatment through the London resource discount in the past.

7. Without any safety net the shifts in the burden of domestic taxation between the rates system and the community charge, based on 1988-89 figures, would be:

South East	gain of £494m
West Midlands	gain of £144m
East Anglia	gain of £ 35m
South West	gain of £ 18m
East Midlands	loss of £ 25m
North West	loss of £ 57m
Northern region	loss of £139m
Yorkshire and Humberside	loss of £231m
London	loss of £241m

8. The present safety net, agreed by Ministers in 1987, is designed to prevent any of the shifts taking place in the first year of the community charge. The intention is that if authorities hold their spending broadly steady, the community charge in 1990-91 will be about the same in real terms as the average rate bill per adult in 1989-90. But Ministers agreed that no area should be expected to contribute more than £75 per head to the safety net. This will mean that only gains of more than £75 per head would be allowed to come through in the first year. (Mr Ridley explicitly told the House on Second Reading of the Local Government Finance Bill: "We shall limit contributions

to the safety net to £75 per adult.")

9. The latest proposal put forward by Mr Ridley and Mr Major appears to turn this inside out. Instead of only the large gains coming through in the first year, with smaller gains under £75 being used to finance the losses in that year, the new system would allow through the small gains in that year, with 75 per cent of gains over £20 being used to finance all losses of over £25. **This raises important points which need to be explored.**

i. **The practical effect**. Some areas would be a lot worse off under this approach. For instance, the community charge for Westminster without a safety net on the basis of standard spending would be £340 compared with an average rates bill of £587. Under the present safety net the community charge would be increased by £74 to £414 per head. Under the proposed new safety net the community charge would be increased by £140 to £480.

ii. **Rationale**. Mr Ridley would need to explain to Parliament the reason for the change in approach. He would be able to point to all the authorities where small gains would be allowed to come through earlier. But the areas with large gains would be likely to object, as would areas with small losses.

10. The formula was only worked out between the two Ministers last night. **You may feel that it needs some more exploration, together with illustration of other options, before decisions are taken**. The details do not need to be settled finally before the autumn, provided that they are consistent with the grant settlement announced in July. In practice the main immediate issue is whether the safety net should be self-financing, without the need for additional Exchequer grant. This is what concerns the Treasury. Subject to that there is time for further work.

Yes

HANDLING

11. Mr Ridley and Mr Major propose that the paper for E(LF) should simply put forward the grant settlement which they have agreed, without other options, and ask colleagues to endorse it. They would have nothing up their sleeves to concede in the face of pressure. **You will wish to decide whether this is the right approach.** The alternative would be to invent options which neither of them is now pressing for and stage a mock negotiation.

12. The case for a higher level of standard spending will be argued primarily by the service Ministers: the Secretaries of State for Education and Science, Transport, Health and the Home Secretary, with support from the Secretaries of State for Wales and Scotland. The Chancellor of the Exchequer will attend to support Mr Major and Mr Ridley. Other members of the Committee who may also do so include the Secretaries of State for Energy and for Employment, and the Lord President. The Secretary of State for Social Security, the Lord Privy Seal and the Chancellor of the Duchy of Lancaster have no major departmental interest.

RTJW.

R T J WILSON
Cabinet Office
16 June 1989