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CABINET

STEERING COMMITTEE ON LOCAL GOVERNMENT FINANCE STUDIES

DRAFT GREEN PAPER ON LOCAL AUTHORITY FINANCE

Note by the Secretaries

Enclosed are the contents sheet, draft foreword by the Secretary of State, Chapters 1 and 4 of the Green Paper on the background to the local government finance studies and the new grant arrangements, and Annex C on the present system. These do not yet reflect the Department of the Environment Ministers' comments.

There will be additional, separate chapters on Scotland and Wales after Chapter 5.

Could drafting comments be sent to Jill Rutter, Room N6/15, Department of the Environment, Marsham Street, as soon as possible. These chapters, and chapters 2 and 3, will be discussed at E(LF)(O) on 2 December.

Signed J E ROBERTS
J RUTTER

Cabinet Office

25 November 1985

(Version of: 20 November 1985)

THE LOCAL GOVERNMENT FINANCE REVIEW

Contents

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FOREWORD BY THE SECRETARY OF STATE FOR THE ENVIRONMENT

0.1 The last decade has seen many changes and proposals for change in the local government finance system. In the later seventies there were the Layfield Report, and the Labour government's proposals for unitary grant and "organic change" - which could not have been given effect without radical financial reform. Since 1979, there has been a series of legislative changes and consultative documents. The system of central government grant aid to local government was modified through the introduction of block grant and expenditure targets. On a different but related front, the 1981 Green Paper "Alternatives to Domestic Rates" ranged over a series of possible ways of funding the local contribution towards the cost of local services. This was followed by a White Paper (Cmnd 9008) which reluctantly concluded that the rates would have to be retained, but heralded the introduction of rate-capping to protect ratepayers from being required to support excessive levels of spending.

0.2 Why has there been this continuing concern with local government finance? Why has the government embarked on yet another review?

0.3 The concern stems from two main causes

- the need to ensure that local authority spending is consistent with what the nation can afford, and

- the inadequacies of rates as a local tax.

0.4 There have been many debates about whether and to what extent central government should concern itself about the level of spending by local authorities. It is often pointed out that public expenditure as we define it is not a concept that exists in thriving western economies such as the United States and West Germany. It is sometimes argued that local government spending is not "really" public expenditure at all.

0.5 The fact of the matter is that spending by local government clearly is public expenditure in the very real sense that it is funded largely by taxes, both national and local. The dividing line between central government and local authority services is a matter of statute and convention. It makes no sense in economic terms to regard expenditure on one side of this line as public, and expenditure on the other side as not public. If for example education were provided in this country, as in France, by central government, it would be absurd to argue that a decision to hand over responsibility to local government would give rise to a huge cut in public spending.

0.6 In federal countries like the USA the individual States have their own taxation powers and are seen to have a direct responsibility for economic performance. In a unitary state such as the United Kingdom local authorities have no taxation powers apart from those given by Parliament, and central government is responsible for the key economic decisions. The total demand on the taxpayer of all parts of the public sector must therefore be a matter of national concern.

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0.7 We cannot afford to borrow to finance growth in current expenditure. That is the road to ruin. So **if spending in one part of the public sector goes up, then either taxes must go up or spending in another part of the public sector must go down.** It is that simple arithmetic that has dominated the financial relationship between central and local government in the eighties. The government believes that the burden of taxation must be reduced, and so if one part of the public sector spends more than its share, other parts must have less.

0.8 But what should local government's "fair share" of public spending be?

0.9 There are two ways of tackling this question. First, the "top down" approach. The government has a right and a duty to take a view about the relative priorities of different types of public expenditure. This is essentially a role for central government, since the claims of services both within and wholly outside the local government field - such as defence and foreign affairs - have to be weighed in the balance.

0.10 Then there is the "bottom up" approach: how much more are local electors prepared to pay for extra spending on their services? If people are given a clear account of the costs, and if they themselves have to foot the bill, they will make sensible choices about the balance between higher local taxes and more spending.

0.11 Sadly, as this Green Paper will show, under the present financial arrangements local electors do not have a clear account of the costs of extra spending on their services, and a very high proportion of those costs is met by people with no voice in local elections. The pattern of choice is distorted. Local people seem to be getting a good bargain. But of course nothing is for nothing. The marginal cost of local services is kept down by taxpayers' money, or by the higher prices charged for goods and services to meet increased business rates, to which they themselves contribute. The only net gainers are those who benefit from local services but pay only partial rates or no rates at all. They gain, but at the expense of fellow residents who do pay full rates. This leaves the ratepayers of some authorities open to exploitation. It was this factor that forced central government in 1984 to intervene directly to limit the rates that the highest spending authorities could levy.

0.12 But rate-capping cannot be the right answer for the majority of authorities or for the longer term. The central government cannot abandon its concern with the level of local government spending - we were elected to take views about national priorities and cannot shrug off that responsibility. But an undue emphasis on "top down" pressures is unhealthy. It causes unnecessary conflict, and in the end it can sap the vitality of local government. The only alternative to continuing intervention from the centre, however, is the restoration of local democratic pressures. We need to make sure that local authorities are genuinely accountable to their electors for their spending decisions. A fairer local taxation system must be the cornerstone of such an approach.

0.13 Rates are collected both from **'non-domestic'** ratepayers - industry, commerce, and public establishments such as universities - and from the **'domestic'** ratepayers who are the householders of a local authority. Both non-domestic rates and domestic rates have serious defects.

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0.14 Non-domestic ratepayers meet well over half the rate bill in most authorities. In some they meet more than [redacted]%. This bears no relationship to the value of the services provided to them - in many cases the authority also charges businesses for services like refuse collection - and non-domestic ratepayers have no vote in local elections, although of course a businessman who is a domestic ratepayer of an authority can vote in that capacity. The amounts businesses pay for premises with similar rateable values differ widely in different parts of the country. This often erodes their competitiveness in areas where unemployment is already high.

0.15 Is this acceptable? In a democracy there will always be divergences between what people pay and their voting power. But the lack of any clear relationship between what non-domestic ratepayers contribute to an authority and what they get back, and their inability to vote for changes in the spending policies of their authorities, make non-domestic rates a poor local tax.

0.16 The weaknesses of domestic rates are well known. The system operates on two assumptions: that local taxes should take no account at all of the demands people make on local services; and that the values of the houses people live in are a fair reflection of their ability to pay. Both of these assumptions are flawed. Most people would accept that rates should take some account of the demands made by a household on local services. Many services provided by local authorities provide a direct benefit to people who are well able to pay. There is a wide measure of agreement that in these circumstances it is unfair for a single person to pay just as much as a family with several adults. It is also widely recognised that the assumption that the value of a house is a fair indication of ability to pay is true only in a very broad-brush sense. For example, couples with children will generally live in bigger, more expensive, houses than couples without children who have similar incomes.

0.17 These defects in the rating arrangements mean that we cannot give up the search for better and fairer ways of spreading the cost of local services between local people. The problems need to be resolved not only on grounds of equity but also because the unevenness with which the burdens fall contributes to the present weakness of the "bottom up" pressures on local expenditure.

0.18 Improvements to the local tax arrangements will not be enough on their own. If local people are to exercise their influence over local financial decisions effectively, they need to understand the link between changes in local spending and changes in the local tax bill. At the moment, that link is hopelessly obscured by the grant system.

0.19 Block grant, introduced in 1980, is a model of clarity and simplicity by comparison with its predecessor ... but that is not saying much! Because of the way the grant is linked to the actual spending and to the rateable values of authorities, the cost to the ratepayer of an extra £1 per head spent on services can vary between authorities by as much as [redacted]p per adult. Furthermore the grant entitlement changes after the rates have been set, so that shortfalls or surpluses have to be reflected in the rates for later years.

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0.20 If local taxation is changed, the present grant arrangements will have to change too, because they are inextricably tied to the existing rating system. We must put that change to good use. We should instal a grant system that will make the link between spending and paying crystal clear to local electors.

0.21 A clearer grant system of this sort, coupled with a fairer local tax system that is a better reflection of the use made of local services, will meet the twin objectives that have made it necessary to embark once more on a re-examination of the local government finance system:

- to restore a healthier balance between central and local democratic control of local government expenditure;

- to remedy the unfairnesses of the rates.

0.22 Changes to meet these objectives will necessarily be far-reaching. They will have profound consequences over the years on the health of the relationship between central and local government in this country, and they will strengthen the democratic base of local government. But inevitably, such radical restructuring will produce big changes in the pattern of costs and benefits facing individual families. It is no part of the government's intention that change should come about in a manner which is disruptive and painful for households. The present finance system, with all its defects, has been the framework within which people have taken important financial decisions. It cannot be easily or quickly overturned. It will therefore be essential that changes come about through a smooth and gradual progression so that adjustments can be made at a realistic pace.

0.23 It is against this background that the Government has decided to undertake this new study of the local government finance system. In doing so we have returned to first principles, looking carefully at the objectives which such a system should aim to meet, measuring the present system against these objectives and considering possible arrangements to deal with its shortcomings. In many cases there is a range of possible solutions to the problems. Where this is so, the alternatives are set out, together with the advantages and disadvantages of each, and any provisional conclusions that the Government has reached. The Government's aim is to stimulate a wide-ranging debate on the topics that are raised. Only then will we reach final decisions on the changes to be introduced.

K.B.

<u>Comments on the Green Paper, and the options outlined, should be sent to [redacted] by [redacted].</u>

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CHAPTER 1: WHY CHANGE LOCAL GOVERNMENT FINANCE?

The background

1.1 In some ways, the debate about local government finance is unchanging. Many of the arguments that are considered in this Green Paper are as old as local government itself. But, in other ways, change in recent years has been very rapid, and has introduced important new factors into the debate.

1.2 Local government has become a business so big that it has over 1½ million full-time, and nearly one million part-time, employees. It accounts for a quarter of all public expenditure, and 10% of GDP. This year, the services provided by local government will cost £[redacted] billion in England alone. There has been a shift in the nature of these services, with a particularly significant increase in welfare services - help for groups such as the elderly and children at risk. Local government has become more politicised : in 1945 [redacted]% of councillors were Independents; now the figure is only [redacted]%. Against the background of the measures which were needed to tackle our economic problems and the pressures on public expenditure generally, the natural tension between central and local government has inevitably increased.

A Historical perspective

1.3 In this country, all the powers of local authorities derive from Parliamentary legislation. The structure of local government, the services it provides, and the way in which it finances those services are - and always have been - subject to statutes passed by Parliament.

1.4 There have been a succession of reforms of the structure of local government, from that of 1888 - which ended the system of appointed county government - to the changes introduced in 1974, and the imminent winding up of the GLC and the metropolitan county councils. From time to time Parliament has imposed new duties on local authorities, ranging from the provision of police and education in the nineteenth century to more recent examples such as the responsibility to house homeless families. There have also been occasions when Parliament has decided that certain responsibilities which local government had been carrying out could be better discharged in other ways. Local authorities ceased to be responsible for prisons in the 1870s, trunk roads in the 1930s, gas and electricity in the 1940s and water in 1974.

1.5 Parliament has also exercised control over the financing of local government, in terms both of the nature of local government's own sources of revenue, and of the extent of Government grants and the method of allocating them. Although there is some truth in the suggestion that rates go back to the reign of Elizabeth I or earlier, it is equally true that the rates as we know them - a unified local tax - did not exist until the end of the nineteenth century. Before that there were several different 'rates' for different purposes. These included highway rates, improvement rates, poor rates and school rates. Not all of them were assessed in the same way. Parliament has also experimented with other methods of funding local services - such as a system of assigned revenues, used for a time at the end of the nineteenth century.

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Central and local government services

1.6 Until the nineteenth century, there was scarcely any overlap at all between the responsibilities of central and local government. Central government's energies were directed towards foreign policy and defence. Local government was responsible for other services which it was felt should be carried out by the state - primarily the relief of poverty. Individual authorities were left to interpret the needs of their areas as they judged them, and cater for those needs as they saw fit.

1.7 Even in the nineteenth century, as Parliament gradually became more interested in domestic affairs, it proceeded slowly in imposing new duties on local government in the fields of law and order, public health and, in due course, education. It tended first to encourage, then to provide enabling legislation, and only after that to impose duties.

1.8 There were no regular grants from central Government to local authorities before 1835. Even by 1879, grants amounted to less than 10% of local authority revenue. Parliament was, of course, also concerned with taxation, where the revenue from rates exceeded that from income tax every year until after the First World War. But the narrow range of local authority services still meant that rate bills were relatively small: in 1870, local authorities were spending only about £H for every person in England - roughly £H at today's values - compared with £H today.

1.9 Gradually the picture changed, in two main ways. The first was that Parliament began to concern itself much more with the services that local authorities were providing, feeling that some were of such importance that they should be provided to at least a minimum standard throughout the country. The second factor was that central Government itself began to be involved in assistance for the unemployed and other disadvantaged groups. In doing this, it began to concern itself in matters which, for earlier generations, had been the concern solely of local government.

1.10 Even though central government was gradually taking over local authorities' Poor Law responsibilities, local government spending grew steadily in the first half of the twentieth century. In real terms it increased by nearly 350% in the sixty years between 1890 and 1950. It was also taking up an increasing share of the nation's wealth, rising from under 5% of Gross National Product in 1890 to about 12% in 1950 (for a short period in the 1930s it had exceeded 15% at a time when private sector output had fallen dramatically).

1.11 After 1950 spending continued to grow. Only 25 years later, in 1975, it had increased by almost a further 300% in real terms. And it was still increasing at a faster rate than the nation's wealth - so much so that it accounted for 18% of GNP by 1975. The full costs of this increase in spending were hidden from ratepayers by a steady increase in the central government grants for local authority services. By 1975 65% of all local authority expenditure was paid for out of central taxation, via government grants.

1.12 This trend could not continue indefinitely. In 1975 Anthony Crosland, then Secretary of State for the Environment, made his famous declaration that "the party's over". The Labour Government reduced the rate of Exchequer support to 61% by 1978-79. Under pressure from the IMF it asked for, and got, a substantial reduction in local authority current expenditure in 1977-78; and it

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made big cuts in some capital programmes - reducing housing expenditure by [redacted]% over [redacted] years. But by the end of the 1970s, current expenditure was already beginning to increase again, and was planned to go on growing, at about [redacted]% a year in real terms. In other words, local government was contributing significantly to the increasing burden which the public sector as a whole was imposing on the wealth-creating sector of the economy. This was the situation which confronted the incoming Conservative Government in 1979.

Local authority spending and economic policy

1.13 The Conservative government came into office committed to economic regeneration. This meant ensuring that the public sector took a smaller share of the wealth created by private enterprise. A large public sector absorbs resources which could be put to more efficient use by the private sector. And it is likely to be undertaking activities which could be carried out more efficiently by the private sector, operating under market pressures. Public expenditure has to be financed primarily from either borrowing or taxes. The government therefore set itself the task of limiting both public borrowing and the level of taxation.

1.14 These concerns apply just as much to local authority spending as to central government spending. Local authority borrowing for capital projects amounts to £[redacted]bn a year - [redacted]% of the total Public Sector Borrowing requirement (PSBR). Curbing the rate of monetary expansion is central to the government's policies for reducing inflation and laying the basis for sustained economic growth. That in turn requires public sector borrowing to be closely controlled if interest rates are to be held to acceptable levels. Higher local authority borrowing makes it harder for the government to achieve these objectives.

1.15 Some commentators, while accepting that central government has a legitimate interest in the level of borrowing and the total of government grants, argue that expenditure financed in other ways can remain uncontrolled - and, indeed, that it may not be necessary to define it as 'public expenditure' at all. This argument, however, misses several important points.

1.16 The government must be concerned with the level and composition of gross capital spending, however it is financed. Capital projects represent the growth points of the local authority sector. The size and balance of capital expenditure must therefore take full account of national policy on the scope for expansion of local authority service spending.

1.17 Nor can the government's interest in revenue expenditure be restricted to a concern about the level of grant. As Figure 1 shows, rates account for 11% of all taxes levied in this country; and another 17% of taxes are accounted for by government grants to local authorities. The Government believes that high tax rates are the enemy of a dynamic economy. They act as disincentives to activity in the private sector, as the rewards of enterprise are diminished. These arguments apply just as much to local taxes - domestic and non-domestic rates - as to income tax or corporation tax. For the householder or industralist there is very little difference between local and national taxation.

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Figure 1: Local authorities' claim on the total tax burden (United Kingdom)

1.18 The illogicality of suggesting that only local authority spending financed by grants or borrowing should count as public expenditure can be seen by considering what this would mean in practice. For example, if local authority spending remained steady but £5bn more of it was financed from rates and £5bn less from government grants, the total of public expenditure would, under this definition, fall by £5bn. The same thing would happen if central government transferred £5bn worth of its spending responsibilities to local authorities. In both cases, however, while central government's tax bill would fall, that reduction would be offset by an increase in the local tax bill - the rates. The overall burden of taxation on the economy would be unchanged.

1.19 That is why the government has taken the view from the outset that its objective of reducing public expenditure and taxation must apply just as much to local authority spending as to central government's own spending.

Policy since 1979

1.20 The Government's policies on local government finance since 1979 have had three main strands:

i. a concern to contain local government expenditure at affordable levels;

ii. encouragement to authorities to carry out their services more efficiently, and to introduce private sector competition where possible;

iii. a reduction in detailed controls over local government.

1.21 The Government's initiatives in this field, directed to all three purposes, have included:

- the abolition of ■ detailed controls over local government, such as ■;

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- the establishment of the Audit Commission, one of whose major task is to advise local authorities on value for money;

- new rules on local authority direct labour organisations, including public tendering for most sizeable contracts;

- a new system of controlling capital expenditure, rather than just borrowing approvals;

- a new method - known as block grant - of allocating the main, unhypothecated grant towards local authority expenditure.

1.22 The Government remains committed to all three of the objectives set out in paragraph 1.20 above. But any reduction in detailed controls can only take place in the context of a system where the government can be satisfied that its overall public expenditure policies are being met.

1.23 Under the block grant system, which came into operation in 1981-82, the proportion of an authority's overall expenditure met by grant was less if it spent significantly more than was needed to provide a standard level of service (see Annex C). This was intended to encourage those authorities which were spending most to make the largest contribution towards the savings needed.

1.24 It quickly became apparent, however, that something more than this would be needed if the reductions in local authority spending that the government thought necessary were to be brought about. The local government finance system worked in such a way that the effect of the block grant pressures was greatly reduced by the time they reached local domestic ratepayers. Why this should be so is analysed in more detail in paragraphs ■ to ■ below. This made it easier for some authorities to decide that they would not contribute to the expenditure reductions asked for by the government. Indeed, faced with a general request for revised budgets, a handful of authorities responded by proposing increases in the spending they planned to undertake. With great reluctance, the government saw that, if it was to succeed in controlling local authority expenditure, it would have to take stronger measures.

1.25 The government therefore decided to supplement the block grant system with a system of expenditure targets for every authority, based on its actual spending in earlier years. Any authority which exceeded its target had its block grant entitlement reduced so that it had to raise a much higher contribution from its local taxpayers.

1.26 For 1986-87 the government is discontinuing the system of individual targets. Instead, it will seek to achieve similar effects by greatly increasing the basic block grant pressures.

1.27 The government has also reduced the overall proportion of local authority expenditure met from Exchequer grants. This fell in stages from 61% in 1980-81 to 49% in 1985-86.

1.28 Throughout, the government has faced particular problems in dealing with a handful of the highest spending authorities. In 1983-84 local government's budgeted expenditure exceeded the Government's targets by £770m. 75% of this

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was accounted for by the top 16 overspending authorities. A similar pattern occurred in 1984-85 when 75% of the overspend of £850m was attributable to just 12 authorities. Many of these were still increasing their expenditure. In 1984 Parliament passed the Rates Act, which gave the government powers to set limits to the rates which some of these high-spending authorities could levy. These powers were used for the first time in 1985-86.

Success and failure

1.29 These financial pressures have had some success:

- the annual rate of growth in the volume of local authority current expenditure has fallen from over 3% in [redacted] to under 1%;

- local authority manpower has fallen by 5% since 1979;

- despite the cut in the grant percentage, average rate increases have fallen from 22.7% in 1980-81 to 5.5% in 1984-85 and [redacted]% in 1985-86.

Figure 2: Trends in local authority expenditure, rates, and manpower

1.30 Compared with the trends of the 1960s and 1970s these results represent a considerable achievement. Even so, they mean that current expenditure is still growing and now represents a higher proportion of GDP than it did in 1979. Every year, the government has been forced to increase the amount allowed for local authority current expenditure in its public expenditure plans, because of the failure of local government to carry out the reductions in expenditure it wished to see. The reduction in local authority manpower, of 5% since 1979, is modest compared with achievements elsewhere in the public sector. And the manpower total has been more or less static since the end of 1983.

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1.31 Such successes as have been achieved have also carried a heavy price. To secure any significant reduction in the total of local authority spending under the target system, the government needed to ask for expenditure savings based on previous years' spending levels from low-spending authorities. Councils which had a long tradition of careful husbandry and efficiently-provided services found it increasingly painful to make further savings from a low base. This is why the Government has discontinued the system of expenditure targets for 1986-87.

1.32 The grant system has also become increasingly complicated. As well as causing problems for authorities in managing their budgets, this complexity has tempted some authorities to devise special accounting techniques to maximise their entitlement to grant in a particular year. The link between changes in spending and changes in local tax bills has become more and more obscure.

1.33 The overall effect of these factors has been to increase the tension between central and local government generally and to bring the government into conflict with the highest-spending authorities.

Why have these problems arisen?

1.34 The government's concern to restrain local authority expenditure and taxation has revealed serious shortcomings in the local government financial framework and in local accountability. These problems have not been caused by what has happened since 1979. The flaws have been inherent in successive systems over many years. But the inevitable tensions that have arisen - in a period when a government, for the first time since the war, has been seeking to exercise continuing restraint over local authority spending - have drawn attention to their importance in a way that has never happened before.

1.35 Shortcomings arise as a result of problems in three main areas:

i. the extent to which local authorities' marginal spending is funded by non-domestic ratepayers;

ii. the mismatch between those who are entitled to vote in local elections, and those who pay domestic rates;

iii. the operation of the grant system.

(i) The contribution from non-domestic rates

1.36 60% of the rate income of local authorities in England comes from the non-domestic sector. This includes commerce, industry, public utilities and other public buildings. After rate rebates, only 40% comes from domestic ratepayers (see Figure 3).

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Figure 3: Sources of rate income (England 198[redacted])

1.37 These contributions by industry and commerce have the crucial effect of ensuring that domestic ratepayers have to pay on average less than half the local contribution to increased spending. The remainder is met by government grants and non-domestic ratepayers who have no vote.

1.38 In some authorities the proportion of local taxes met by the non-domestic ratepayers rises to over 70%. The temptation in these circumstances to increase spending on services for the voting domestic ratepayers largely at the expense of the non-voting non-domestic ratepayers is very great.

(ii) Those who vote and those who pay

1.39 The poor linkage between those who vote and those who pay has been further weakened by the fact that many of those who are entitled to vote for higher standards of local authority services either do not pay rates at all, or do not pay full rates. There are 35m electors in England. Of these 18m are liable to pay rates. Of course, many of the remaining 17m will be spouses of ratepayers'; but they are not billed direct, nor do they personally make any payment to their local authority. Other members of ratepayers' families may have even less appreciation of the cost of local services.

1.40 Figure 3 shows how substantial a proportion of the domestic rate bill is met by rebates. Of the 18m liable to pay rates, only about 12m actually pay their rates in full. 3m receive partial assistance with their rates and the remaining 3m receive full relief from their rates bill. This last group know that, under the present arrangements, they can vote for higher services without having to pay a penny towards them. Even for those who receive only partial help, the rebates damp very substantially the effect of increased local authority spending.

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1.41 The picture varies from authority to authority. Some urban councils have large concentrations of industrial and commercial development and a high proportion of voters also receive rebates. In the extreme case, domestic ratepayers meet on [redacted]% of the rate bill from their own pockets - less than [redacted]% of the authority's expenditure.

1.42 Rates are currently the only form of local taxation. Domestic rates have many technical advantages. But they do not take any account of the composition of households or their consumption of local government services. This was less relevant in the past when, as noted earlier, local government was responsible for services such as gas, electricity and water where the basic provision was related to property ownership and consumption was charged for. But today most local authority services are provided for people, rather than property. Education alone accounts for [redacted]% of local authority current expenditure.

(iii) <u>The grant system</u>

1.43 Accountability is also impaired by the way in which grants are paid to local authorities. Though it is less true of block grant than of its predecessors, it has generally been the case that an authority that increases its expenditure gets more grant. Ratepayers in that area find that part of the cost of having a higher standard of service is met from general taxation - by people living elsewhere in the country.

1.44 Moreover, successive governments have also paid grant to compensate authorities for variations in rateable value. In terms of what ratepayers are actually asked to pay, the use of grant to compensate for variations in rateable resources, has a rather odd result. It ensures that different authorities can charge the same rate <u>poundage</u> for equivalent spending levels, but that gives very different rate <u>bills</u>. To pay for a similar increase in spending, authorities in areas where rateable values are low need to increase their rate bills by a smaller amount than high-rateable value authorities. This means that the rate bills faced by households are lower in some authorities which spend a lot on services than they are in other areas where spending is lower. The individual ratepayer in Gateshead, for example, faced with an average bill of under £300 a year, might assume that his authority's spending was modest compared with that of Guildford where the average bill was £417. But in fact it is Guildford which is the lower-spending authority. If Guildford had the same level of spending as Gateshead the difference in rate bills would be even greater.

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Figure 4: **Rate bills in Gateshead and Guidford**

The direction of reform

1.45 Local government finance is at a crossroads. The government needs to be able to influence the total of local authority expenditure, as part of its overall economic policies. Yet its attempts to do so are frustrated by a tax and grant regime which depresses and distorts the cost of marginal increases in expenditure. As a result electors are either indifferent to the level of expenditure adopted by their local council or are encouraged to vote for higher service standards than they would be prepared to finance if they bore the full marginal cost themselves. To achieve even modest success in restraining expenditure, the government has therefore had to bring steadily increased direct pressure to bear on the highest spending authorities.

1.46 Some improvements are possible within the context of the existing arrangements. The government is already proposing, as part of the Social Security review, to make one important change. It envisages that, in future, all domestic ratepayers should be required to pay at least 20% of the rate bill they face. This will re-establish a financial link between 3 million households and the local authorities in whose areas they live. But it will still leave many problems unresolved. The need for fundamental reform will still exist.

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What kind of reform?

1.47 There are three main possibilities for reform:

- changing the structure of local government;
- imposing much greater central control over local authorities;
- financial reform designed to improve local accountability.

(i) Changing the structure of local government

1.48 There are some who will argue for a further upheaval in local government structure. The model the advocates of this approach have in mind is a federal structure: provincial councils taking major economic and planning decisions with, below them, single-tier authorities responsible for all day-to-day services. It is true that there could in theory be some gain in accountability if we were to have all-purpose local government throughout the country. Ratepayers would then know that the spending decisions of one authority lay behind their bills. But this gain would be achieved at the cost of the enormous disruption which a further large-scale local government reorganisation would cause. And, in the course of that reorganisation, we should be forced, yet again, to face up to the fact that different local government services can best be provided by authorities of different sizes.

1.49 Moreover, any proposals which include a regional tier of government will have to consider what the role of those provincial authorities should be. The issues have been extensively discussed in the last 20 years following the proposals of the Redcliffe-Maude Committee. The debate about devolution showed that there is little support for the major constitutional change that would be needed to move to a federal structure.

1.50 Nor would changes to the structure of local government deal with the underlying financial problems set out in this chapter. Tackling those means facing up to the choice between increasing central control and improving local accountability.

(ii) Increasing central control

1.51 Increased central control of local government spending may at first sight, appear an easy answer to the problem as its results could be substantial and guaranteed. There are a number of possible models for a centralised system. One would simply be to impose a general limit on rates. Another would be to fund one or more of the main local government services from general taxation, with the budget for each set by central government. Or a substantial slice of spending on services - for example teachers' salaries - could be taken to the centre.

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1.52 But any system based on more extensive central control of local authority spending would have major drawbacks.

- Introducing a general limit on rates would mean extending rate-capping to most, if not all, authorities. Setting limits which brought about reductions in expenditure where appropriate, but also took account of the different circumstances of individual local authorities would require government Departments to get drawn into the detailed financial affairs of every authority.

- Introducing central funding of the whole of education, personal social services, police, fire and highway maintenance expenditure would enable the government to control about three quarters of local authority spending. There would be a division of responsibility between these services and others, with purely local characteristics, financed from local sources. But having local government acting merely as agents for the main services would deprive authorities of any incentive to manage them efficiently. A big increase in central government bureaucracy would be needed to enable the need for services to be accurately assessed through the country.

- Central funding of teachers' salaries alone would provide control of over half of education spending, or a fifth of all local government expenditure. But it would mean that the government had to take responsibility for the number and grading of teachers in each authority, or possibly in each school. This too would require a significant increase in central government manpower.

1.53 The Government has a responsibility to ensure that what the public sector spends is consistent with what the country can afford. It cannot abandon its concern with the level of local government expenditure. But neither structural reform nor increased central control offers an attractive way of fulfilling that responsibility. The alternative is to increase local accountability within the present structure. This is more attractive on several counts. It guarantees the continued existence of a healthy system of local government. In the longer term it should help to ensure that services are provided more efficiently. And it strengthens the link between the local authority and those who live in its area. For the vast majority of people, this is the preferable way forward. But it can only work if we are able to deal with the shortcomings which this chapter has identified.

(iii) Improving local accountability

1.54 Local accountability depends crucially on the relationship between paying for local services, using such services and voting in local elections. At the moment there are worrying gaps. 60% of total rate income comes from non-domestic ratepayers with no vote. Of the 35 million local electors in England, only 18 million are liable to pay rates, and a third of those receive full or partial rebates.

1.55 These problems are accentuated by the arrangements for paying government grants to local authorities. They make it impossible for ratepayers to see a clear relationship between the spending behaviour of the authorities in whose area they live, and changes in their rate bills.

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1.56 This suggests that there will be three main elements in a new finance system based on improved local accountability.

- Better arrangements for the taxation of non-domestic ratepayers so that their contribution to local services does not conceal from local voters the true costs of increased spending.

- A more direct and fairer link between voting and paying, so that more local voters contribute towards the cost of providing local authority services.

- Clearer grant arrangements, so that the consequences of increases or reductions in spending are felt directly and straightforwardly by local domestic taxpayers.

1.57 This central issue of improved accountability is discussed in detail in the chapters that follow. The first three of these deal separately with local non-domestic taxes (Chapter 2), local domestic taxes (Chapter 3) and grants to local authorities (Chapter 4). Each considers the shortcomings of the existing arrangements and sets out possible alternatives.

1.58 Chapter 5 discusses the effects for households and local authorities of the improvements to local accountability discussed in the previous three chapters. Chapters 6 and 7 discuss other issues affecting the financial framework within which local authorities work, including the system of capital expenditure controls. The conclusions of the review are set out in summary form in Chapter 8.

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CHAPTER 4: GRANTS

Introduction

4.1 Chapters 2 and 3 set out proposals for major changes to the way in which non-domestic rates are paid; and for a new system of local domestic taxation, designed to increase local accountability. At present about [redacted]% of the cost of providing local authority services is met by non-domestic ratepayers. A further [redacted]% comes from domestic rates. But the largest contribution, [redacted]%, is provided by national taxpayers as central government grants. This chapter looks at the place of grants within the present local government finance system and sets out the government's proposals for change.

Why do we have grant?

4.2 Grant systems for local authorities have grown up because successive governments have taken the view that it would not be appropriate to expect the whole cost of providing local authority services in each area to be met solely by the local taxpayers of that area. This reflects a national policy that essential services, such as education, should be provided to an acceptable standard country-wide whether or not the taxpayers of particular areas can afford to pay for them. Over the last 20 to 30 years, Government grant systems have sought to achieve this objective by three different means: compensating for differences in <u>expenditure needs</u> between local authorities; compensating for variations in local authorities' <u>taxable resources</u>; and ensuring that a substantial proportion of local authority expenditure is paid for out of <u>progressive taxation</u>.

(i) Equalising needs

4.3 Some authorities inevitably face much greater calls on their services than others. The proportion of the population who are of school age, for example, varies widely across the country: children between 5 and 16 make up [redacted]% of the population in [redacted] but only [redacted]% in [redacted]. At the other end of the age scale, the proportion of pensioners living alone ranges from [redacted]% in [redacted] to [redacted]% in [redacted].

4.4 It also costs more to educate a child or provide support for an old person in some parts of the country than in others. One reason is the nature of the area. Thinly populated areas face higher transport costs, for example. And other factors can also have a big impact - like the extra cost of educating children whose first language is not English. Authorities in London face higher wage bills as a result of the need to pay their staff London Weighting.

4.5 Where an authority has a concentration of needy people, or is faced with higher costs, it would be unreasonable to leave the entire financial burden to be met locally. To do so would mean that local residents would have to pay higher levels of local taxation than those in other authorities if an acceptable standard of service was to be provided in their areas.

(ii) Equalising resources

4.6 Under the present local government finance arrangements, the taxable capacity of local authority is measured in terms of rateable value per head of population. This varies greatly from authority to authority, largely as a result of the concentrations of industrial and commerical property in particular areas. Block grant is used to compensate authorities with a small local tax base (on this definition of taxable capacity) relative to their populations. If they had to finance their services wholly from local taxation, such authorities would have to levy much higher tax rates than other authorities. Whether or not the tax bills they charged would be higher would depend on their average levels of rateable values.

(iii) Progressive taxation

4.7 As chapter 3 has shown, few taxes are suitable for use at local level. Sales taxes, for example, would be unworkable with the structure of local government in this country. Those taxes that are suitable are not very progressive - they do not increase in line with the rise in incomes. This is true of domestic rates, whose regressiveness is moderated only be special rebates; it is true also of a community charge such as that proposed in Chapter 3. If local services were met entirely out of local taxation, those on low incomes would pay a much larger share of the cost than was justified and this could inhibit the provision of satisfactory standards of service in some authorities. Providing Exchequer grants to local authorities avoids this problem, since they are largely funded by taxes on income and expenditure - such as income tax and VAT - which are highly progressive.

Grants and local accountability

4.8 The fact that grants have to meet several different purposes means that the systems of calculation are inevitably complicated. But it is important that grants should be paid in such a way as to enhance local accountability, not distort it. So far as possible, whatever the problems of calculation, the end result of the grant system should be transparent, so that local residents can see the extent of the help that is being offered from central taxation. And the way that grants are calculated should be accessible, so that people can understand how the size of the grant is determined.

4.9 The most important signal of all to local electors is the relationship between variations in a local authority's expenditure and the change in local domestic tax bills. If the grant system fairly takes account of local needs, it is right that, where an authority decides to spend more than average, the whole cost should fall on the local people who benefit from the extra spending. Under the local taxation proposals described in Chapter 3, all the adults living in the area will be helping to pay for the services that are being provided, as well as having the chance to vote for them. The proposals for grant, discussed below, will ensure that they understand how changes in expenditures on services affect the local tax bill.

The origin of grants

4.10 Sizeable grants began to be paid in the latter part of the nineteenth century, to encourage different areas to provide services of a consistent standard. At first this was achieved largely through specific grants. Some specific grants remain; these are considered separately in paragraphs 4.58 to 4.62 below. But gradually the main form of Exchequer support began to take the form of unhypothecated grants, paid towards local authority spending generally. This chapter is concerned mainly with those grants.

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4.11 Since 1958, all unhypothecated grant systems have contained elements designed to equalise local authorities' needs and resources. Until 1981-82 the two tasks were carried out by separate elements of the grant; since then they have been undertaken as part of the single calculation of block grant.

Before block grant

4.12 The grant system in force between 1974-75 and 1980-81 had a number of serious drawbacks. Two in particular warrant discussion. The first concerns the method used to equalise resources. This involved the Exchequer in effect standing in as an extra ratepayer in authorities with rateable resources below a given level, and paying whatever rate in the £ the authority levied. This meant that the amount of resources grant an authority received rose in proportion to expenditure. The more an authority chose to spend, the more grant it received.

4.13 The calculation of needs grant used regression analysis to select and weight social and economic indicators which correlated with the broad pattern of actual local authority expenditure. It is true that individual authorities could not influence the amount of needs grant they received by their spending behaviour. But the calculation could be affected if a group authorities with similar characteristics spent more. For example, if the majority of urban authorities chose to spend at very high levels, this would be interpreted by the the regression system as greater need to spend in these authorities whether or not the real spending needs of these authorities were correctly reflected in this expenditure levels.

Block grant

4.15 Block grant, introduced in 1981-82, was an attempt to devise a system that would be fairer and more accessible in these respects than the arrangements it replaced. It succeeds in offering a system for supporting local authority spending which is much more logical and defensible than any previous arrangements. Annex C explains in more detail how it works. The basic structure of block grant still reflects the earlier arrangements, however, so that it shares some of their defects.

(i) Calculating block grant

4.16 The amount of grant to which an authority is entitled depends in part on its actual expenditure. Indeed because the total amount of grant available is fixed, every authority's grant entitlement also depends on the spending of all other authorities. Actual spending cannot be known exactly until after the year in question has finished. Meanwhile, authorities have to work on a series of provisional assessments of the amount of grant they can expect to receive. The result is that not only can grant payments change substantially between years, but authorities are given several different estimates of their grant entitlements for a single year.

4.17 The amount of grant an authority gets also depends on the total rateable resources it has at its disposal - the sum of its domestic and non-domestic rateable values. Part of the grant calculation takes the form of an assessment of the amount that an authority can be expected to raise from its own local taxpayers for any particular level of spending. This is a complicated process, producing results which are difficult for non-experts to understand. This

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applies particularly to the phenomenon known as negative marginal rates of grant, described in paragraphs ■ to ■ of Annex C, under which an authority's total grant allocation declines as it increases its expenditure.

4.18 All this means that, although block grant is a logically consistent system it is very hard to understand. The relationship between changes in an authority's spending and changes in tax bills is far from straightforward. If an authority chooses to spend more, the additional cost to ratepayers may be greater or less than the increase; but it is unlikely to correspond to the exact amount by which spending has risen.

(ii) Resources equalisation

4.19 The way in which resources equalisation is undertaken within block grant also reflects earlier arrangements. Very substantial amounts of money are transferred between different parts of the country in a way which is entirely concealed within the operational complexities of the grant system. The map at Figure ■ shows the scale of transfers involved between the various regions: in total, some £■m is being transferred through the grant system from southern and eastern England to the rest of the country. Such transfers may or may not be justified. What cannot be justified is that such substantial transfers - which directly increase or decrease the cost to ratepayers of local authority services - are hidden from view in the complexities of the grant system.

Figure ■: Interregional transfers through resources equalisation (England 198■/8■)

4.20 In addition, the present system of resources equalisation is providing a subsidy to individual domestic ratepayers in different parts of the country in a way which bears no consistent relation to their ability to pay.

4.21 The differences in authorities' rateable resources for which resources equalisation compensates arise for two main reasons : the size and composition of their property base; and the general level of rateable values of properties

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in their area. An authority may have low rateable resources because it has relatively few properties pro rata to population (or relatively few commercial and industrial properties which generally have higher rateable values than domestic properties); or because the general level of rateable values in its area is lower than rateable values for comparable properties in other areas; or a combination of the two.

4.22 Resources equalisation is based on rate poundages - the rate in the £ that authorities levy. It aims to ensure that authorities providing the same level of service have to levy the same rate poundage. The effect of equalising rate poundages is that, in those authorities where average rateable values are low, tax bills on individual properties are lower than tax bills on comparable properties in authorities with high average rateable values. This would not be unreasonable if rateable values bore a reasonable relationship to the ability of householders to pay. Within a local authority area, rateable values probably do bear a reasonable relationship to ability to pay : the occupant of a modern detached four-bedroomed house in a pleasant suburban environment is likely to be better off than the occupant of an ageing two-bedroomed terrace house in a run-down area in the centre of the town. But between different local authorities, the rateable values of comparable properties vary much more than the ability of their occupants to pay. The rateable value of a good quality detached four-bedroomed house in a "good" area in Gateshead is likely to be in the region of £■, while in Guildford it is likely to be £2■. Figure ■ shows the extent of this mismatch by comparing average rateable values and average incomes by region.

Figure ■: Average rateable values and average incomes in English regions (1985/86)

4.23 Resources equalisation is therefore subsidising the cost of local authority services to all ratepayers in authorities where rateable values are generally low. This is the logical consequence of rate poundage equalisation with a property tax. But in terms of what people pay and the services they get it makes little sense. For a comparable standard of service, the occupant of the four- bedroomed detached house in Gateshead pays £■ a year, while his counterpart in Guildford pays £■. Yet for the same consumption of electricity or gas, for example, they will pay very similar amounts.

4.24 Not only is the justification for this situation weak in terms of ability to pay, but people whose bills for local authority services are being substantially subsidised (especially at the margin) have less incentive to be concerned about how much their local authority spends and every incentive to vote for higher levels of expenditure.

(iii) Grant Related Expenditure (GRE)

4.25 Block grant's method of equalising needs is based on grant-related expenditure assessments (GREs). These use objective factors to assess the relative cost of providing a similar standard of service in different parts of the country. Instead of relying, as the previous system had, on general social and economic indicators to measure differences in what local authorities need to spend, the GREs are built up on a service-by-service basis using a client group/unit cost approach. For example, the main factor which determines the need for education spending is the number of schoolchildren; spending on road maintenance is assessed largely according to the length of roads in each area. Where necessary, these main indicators for each service are then adjusted to take account of factors which affect the cost of provision in different areas - factors such as the number of children born outside the UK, and the amount of traffic carried by different types of road.

4.26 This approach makes it possible to see how GREs are made up. This was impossible with the purely statistical needs assessments used under the previous system. But the system does encourage complexity. There is a temptation to make GREs over-complicated by introducing new factors and by continual refinement.

Objectives of a new grant system

4.27 The earlier part of this chapter has explained why grants to local authorities have developed, and the form they have taken. It has shown that block grant is a significant advance on the systems that went before, but that shortcomings still exist: it is still highly complex and difficult to understand, both for authorities and ratepayers; it is unstable; and it distorts and obscures the relationship between changes in expenditure and changes in local taxes.

4.28 The Government believes that the national taxpayer should continue to contribute via grants to the costs of providing local authority services. But in the light of the above analysis, it believes that the present system needs

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to be reformed. It has identified the following objectives for the design of a new grant system.

- It must compensate authorities for the cost of providing a reasonable standard of service, and local domestic taxpayers should be paying comparable amounts for similar services.

- it should ensure that the cost of spending which is high in relation to normal levels is met by local domestic taxpayers, and that, similarly, they benefit from spending reductions.

- it should be as transparent as possible in its manner of operation - to residents as well as local authorities.

- it should be stable. Local authorities should have greater certainty in their grant entitlements, both within and between years.

There is a further objective which is to avoid unnecessary turbulence in the changeover to new system. This requirement inevitably conflicts to some extent with some of the other objectives.

The government's proposals

4.29 To meet the objective of combining fairness with local accountability, the government proposes a grant system with just two main elements:

i. service grant, to compensate authorities for differences in the cost of providing a standard level of service to meet local needs;

ii. standard grant, to provide an appropriate contribution from central taxes towards the cost of local services.

4.30 Compared with block grant, these arrangements would represent a considerable simplification and clarification. Block grant does three things at once : it equalises needs, equalises resources and pays an additional subsidy per head of population. For reasons set out in more detail in paragraphs 4.47 to 4.52 below, resources equalisation, in the form it has taken in recent years, would no longer be required with a local government finance system such as we proposed in this Green Paper. And the separate treatment of needs grant and H grant will make the basis of central government support much clearer to local taxpayers.

4.31 One part of the present grant system would no longer be needed at all. Under the existing arrangements, domestic ratepayers benefit from a discount on their rate poundages, as compared with non-domestic ratepayers, who do not. The size of the discount is determined by the government. Its cost is met by "domestic rate relief" grant. Domestic rate relief was introduced in 1966 as an interim measure to give some assistance to domestic ratepayers pending a complete overhaul of the rating system which was to follow the Royal Commission on Local Government which was set up that year. In the event, the rating system

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was not reformed and domestic rate relief has remained. However, since it is proposed that non-domestic and domestic taxpayers should now be taxed on quite separate and different bases there is no longer any need for a special discount for domestic ratepayers.

Service grant

4.32 Whatever grant or local taxation arrangements may exist in the future, the Government remains committed to a grant system which compensates authorities for differences in the amount they need to spend to provide a typical standard of services. This applies equally to differences which arise because some areas have greater concentrations than others of people who need local authority services; and to inescapable differences in the cost of providing those services. Without some form of compensation, authorities affected by concentrations of need, or by higher costs, would have to either increase local tax bills, or reduce the standard of service provided. But these differences can be compensated for much more simply and transparently than in the past, through a service grant paid to each authority.

4.33 The calculation of this grant would be undertaken by assessing, for every local authority area, how much it might be expected to cost, per adult living in the area, to provide a standard level of local authority services. The result of the calculation would be a service provision assessment (SPA) for each area. These SPAs would follow similar principles to those used for GREs under block grant, but should be considerably simplified. The way in which SPAs might be derived is set out in more detail in paragraphs 4.40 to 4.44 below.

4.34 From the SPAs, a ranking list of areas would be produced. At the bottom of the list would be the area which could provide an acceptable level of service for the smallest amount per adult. At the top would be the area where the same level of service cost most to provide. In order to pay service grant to every authority, rather than just to one tier, it would be necessary to split the SPAs between tiers of authority in the same area. There would be more than one way of doing this; similar issues already arise with block grant. Whichever method were used, the outcome would be an SPA for every authority. The Government would then pay a cash amount of grant to each authority to meet the full difference in cost implied by the gap between that authority's SPA and the cost of the authority with the lowest SPA per adult in the country. For example, if the lowest cost authority was assumed to be able to provide its services for £350 per adult, then another authority with an adult population of 100,000 where the same standard of services would cost £400 per adult to provide would receive a grant of (£400 - £350) x 100,000 = £5m.

4.35 The total of service grant to each authority would be fixed. It would not be affected by the actual level of an authority's spending. So an authority spending £25 per adult below its SPA would be able to reduce its local tax bill by a full £25 per adult in the area. In the same way, the service grant would not increase if an authority chose to spend more. If it spent £25 per adult more than its SPA, local taxpayers in the area would have to meet the cost of that extra spending in full.

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4.36 The total of service grant will depend on the exact method of calculating the SPAs and splitting these between tiers. The amount needed to equalise needs is however likely to be close to the figure contained within block grant. This is £4.8 billion in England.

Service provision assessments (SPAs)

4.37 Assessing the cost to local authorities of providing an acceptable standard of service has been a consistent thread running through discussions of government grants to local authorities throughout this century. It was Lord Balfour, in his Minority Report to the 1901 Royal Commission, who first suggested that relative need for expenditure should be assessed by finding the lowest expenditure per head of population for a particular service, and assessing grant for all other authorities on the basis of the unavoidably greater cost to them of providing the same standard of service.

4.38 Nothing came of the Balfour scheme until 1929, when a grant system was introduced which tried to assess the relative needs of different authorities. Its approach, however, was to take only a handful of general factors to assess variations in needs across all services. Immediately before the introduction of block grant these factors were selected automatically by the statistical process described in paragraph 4.13 above.

4.39 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. By contrast with the previous statistical approach that simply looked for correlations this meant using factors that laymen and experts alike could see were the ones that actually caused variations in the cost of providing different services - factors like the number of schoolchildren the authority had to educate, and the number of miles of road it had to maintain. The service grant system we now propose will continue to be based on the approach pioneered by GREs. After 5 years experience with GREs, however, certain shortcomings have become evident. The main worries, mentioned in paragraph 4.26 above, concern their complexity and volatility.

4.40 There are several services which feature separately in the GRE formula but on which the variation in spending - and in the GREs themselves - is small. These are services such as cemeteries and crematoria, and school crossing patrols. It is highly debatable whether any gain in fairness achieved by treating these small services individually is worth the complexity that results. It might well be preferable to deal with as many as possible of these minor services together, probably allocating the expenditure simply in proportion to the number of adults in the area.

4.41 For the major services, a client group/unit cost approach remains the most valid method of assessing the cost of providing services in different parts of the country. The problem here is that the detailed formulae for the major services have tended to become increasingly convoluted since block grant was introduced. This constant refinement is understandable. It reflects the fact that there are many factors which can be argued to have some relevance in assessing expenditure needs. But the result is a steady increase in complexity.

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and the introduction of new factors, or new ways of calculating such things as population density, inevitably increases the volatility of GREs. This can lead to substantial changes in the grant of some authorities from year to year that are in no way related to real charges in their need to spend.

4.42 The government therefore intends, in the run-up to the new system, to re-examine critically the GREs for the main services. The aim will be to see whether the existing pattern of GREs can be broadly reproduced using a simplified client group/unit cost approach which is more stable, and more understandable for councillors and their electors.

4.43 It may be possible to introduce some simplifications, both in the treatment of minor services and the number of factors used in the formulae for the main services, before the start of the new system. The government will have this possibility in mind in the normal annual cycle of discussions with the local authority associations. In other cases, it may be appropriate to wait until the new system is introduced before making changes.

4.44 After the new system has been set up, the government also considers that it would be appropriate to minimise changes in later years to the formulae used to calculate the SPAs. Apart from taking account of new sources of data, changes should only be made where there will be a major gain in fairness that will clearly outweigh the disturbance that would be caused. This would mean placing greater emphasis on stability than has been the case in the past, either with block grant or with earlier systems.

Standard grant

4.45 Apart from the amount needed for specific grants (see paragraphs 4.58 to 4.62 below), the government feels that the most appropriate way of allocating the grant left over after service grant has been paid would be as a constant amount per adult to every local authority area, so as to produce a matching reduction in the size of the community charge. This would be in keeping with past RSG arrangements, under which amounts of grant not needed for the purposes of equalisation have been allocated as a constant amount per head. The difference would be that, with the present and previous grant systems, the extent of this support is completely obscured within an overall total that also includes compensation for differences in needs and in rateable resources. With the approach we now suggest standard grant, representing the basic level of taxpayer support to local services, would be a freestanding and identifiable element in authorities' budgets.

4.46 Assuming that the total amount of Exchequer support remained unchanged at its 1985-86 level, and that the amount needed for specific grants did not vary, the total available for use as standard grant would be about £3.4 billion, or £128 per adult across the country.

Resources equalisation

4.47 Under block grant, and its predecessors, some compensation within the grant system for variations in authorities' rateable resources has been essential. Without it, rate bills in authorities with few commercial and

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industrial properties and low average rateable values would soar. Such authorities would not be able to afford to provide a reasonable standard of services. This would clearly not be acceptable. But the fundamental changes in the whole local government finance system now being proposed by the Government offer new ways of tackling the problem.

4.48 The main factor which causes variations in authorities' total rateable resources is non-domestic property. Even excluding London - where there is the greatest concentration of non-domestic resources, non-domestic rateable values in England range from £[redacted] per adult to £[redacted] per adult. Under any system where the entire yield of non-domestic rates lies locally, it is inevitable that the government should intervene to compensate areas with only a small amount of commercial and industrial development; and to draw off some of the income from authorities with large concentrations of shops, offices and factories. Otherwise there would be very substantial variations in local services and local domestic tax bills, caused solely by the extent of industrial and commercial development in different areas.

4.49 However, the proposed arrangements for local taxation of business described in Chapter 2 deal with this problem. Whether non-domestic rates are capped at their current levels or are fixed at a uniform level across the country, the proposal to pool and redistribute the burden as a common amount per adult among all authorities ensures that the benefit of all non-domestic rateable resources is shared equally among all authorities, thus removing a major source of variation. It would of course be a form of resource equalisation, but one which would be clear, explicit and not tied in with the expenditure of local authorities as the present resource equalisation arrangements are.

4.50 If non-domestic resources are pooled and redistributed in this way, variations in authorities' resources arise only in the context of the domestic tax base. If, in future, the tax base were to be simply the adult population of the area - that is, if we were to move entirely to a community charge as proposed in Chapter 3 - each authority would be left with the same taxable resources per adult. With a service grant such as is described above, two authorities spending at the level of their SPA would both have to raise exactly the same amount per adult from those living in the area. There would be no case for separate resources equalisation grant.

4.51 The domestic tax proposals described in Chapter 3 indicate the government's intention to begin its reform of local taxation with a combination of a community charge and domestic rates, with the former increasing as a proportion of the tax base over a period of years, while the latter diminishes. As long as some element of domestic rates is retained, there will be variations in authorities' tax base. But their significance will be much smaller than at present, and under the proposals in this Green Paper, they will get even smaller over time.

4.52 The Government believes that in these circumstances, and bearing in mind that variations in the rateable values of domestic properties between different areas greatly exaggerate the ability of their occupants to pay, there is no case

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for a separate resources equalisation. It will be necessary, however, to ensure that in the initial years of the new system, while domestic rates remain a significant element in local finance, this does not lead to sudden increases in the burden of local taxation. The special arrangements discussed in paragraph 4.56 below and in Chapter 5 will be an important factor.

The effect on local tax bills - without special arrangements

4.53 The Government's proposals:

- that there should be a service grant under which all marginal changes in spending are met by local domestic taxpayers;

- that the proceeds of non-domestic rates should be pooled and allocated as a constant amount per adult to all authorities;

- that there should be no other form of resources equalisation

would mean that some authorities would have to finance more of their spending from their domestic taxpayers than at present. In other areas the burden of domestic taxation would be less than it is now. Low spending authorities with high domestic rateable values would gain most. High spending authorities would lose, and so would authorities with low domestic rateable values.

4.54 The size of the changes would generally be small - for ■% of areas average local tax bills would change by less than £2 a week. But, in a minority of cases, losses would be greater. And, of course, these effects would be superimposed on changes in the pattern of household bills <u>within</u> areas resulting from the gradual introduction of a community charge.

4.55 Allowing the effects of the grant and non-domestic rate proposals to feed through immediately, or within a very few years, would end the confusing situation that exists at present where domestic tax bills are lower in some high-spending areas than they are in authorities that spend much less. But the government is mindful of the fact that householders have taken on commitments on the basis of the present pattern of local taxation. It would be unreasonable to disrupt that pattern too severely or too quickly.

4.56 The government therefore envisages that special arrangements would be introduced to avoid any shifts in the burden of local taxation <u>between</u> areas in moving to a new system. Changes in the balance of local taxation <u>within</u> areas, arising from widening of the local tax base by the introduction of the community charge, would begin to feed through immediately. So would the effects of any <u>increases</u> in spending. But if a local authority maintained its previous level of spending, the average level of its local tax bills would be unchanged. Once the new system is in operation and sufficient time has elapsed to permit a proper assessment of its impact and effects, the basis of the special arrangements would be reviewed at the same time as the review of the phasing out of rates envisaged in Chapter 3, paragraph ■.

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4.57 A more detailed account of the impact of the new system and of the design of the special arrangements is given in the next Chapter, which also deals with the special position of London and the Scilly Isles.

Specific grants

4.58 So far this chapter has been about the main system of unhypothecated grants towards local authority expenditure. But a significant proportion of Exchequer support is paid in the form of specific grants. These make up about 20% of the grant total, amounting to about £2.6 billion in 1985-86. Police grant, which meets 50% of spending on the police service, is alone likely to cost about £[redacted]m in 1985-86. Contributions towards local authority spending on home improvement grants will amount to about £[redacted]m this year. At the other end of the scale, [redacted] grant is worth only £[redacted]m, and that for [redacted] only £[redacted].

4.59 Specific grants take a number of forms. Some are paid towards capital expenditure, some towards current expenditures and some, like slum clearance subsidy, towards a combination of the two. Grant rates vary from [redacted]% in the case of [redacted] to [redacted]% for [redacted]. Some, like police grant, are paid towards actual expenditure on a complete service. Others, like the new education support grants, offer help towards service expenditure of particular types up to a total approved in advance. Specific grants can be either for programmes of expenditure or, as with transport infrastructure grant, for particular projects.

4.60 There will remain a role for specific grants in some circumstances. But, equally, extensive use of such grants could run counter to the approach set out in this Green Paper of local accountability and choice. And it is several years since there was a thorough appraisal of the role of specific grants. It is not clear that the existing pattern of grants can easily be justified in terms of the policy objectives of the 1980s and 1990s.

4.61 The government is therefore undertaking a separate review of the role of specific grants in the new system. In its view, specific grants may be justified where they are intended:

a. to give special encouragement to expenditure or particular activities or services where there is a strong national interest;

b. to compensate local authorities for the cost of activities engaged in at the request of central government where the authority has little or no discretion over the amount of expenditure incurred;

c. to supplement Rate Support Grant in relation to types of expenditure, the need for which arises too unevenly, as between areas or years, to be reflected in a general assessment of expenditure needs;

d. to assist a local authority in the financing of expenditure undertaken for the benefit of a wider area than its own.

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4.62 The government would welcome comments on the principles set out above and, in the context of such principles, on particular specific grants which now exist or might usefully be introduced.

Calculating grant entitlements and obtaining Parliamentary approval

4.63 One of the problems inherent in block grant is that each authority's grant entitlement is subject to change during, and after, the year in question. The Government proposes to end this practice and to ensure that, under the new grant system, the cash total of grant approved before the start of the financial year will be the exact figure that each authority gets.

4.64 This will be possible because grant entitlements will no longer depend on authorities' actual spending; and there will be no grant penalties or holdback. Instead, each authority will know, even before it sets its budget for the year, the fixed amount of service grant it will get; the amounts of standard and special grants; and the exact total it will be paid from the non-domestic rate pool.

4.65 This will greatly simplify local authority budgeting. Every authority will be able to see just what income will arise from these sources, and will know that the gap between that figure and the amount needed to finance its planned spending will have to be met entirely from local domestic taxpayers.

4.66 The total amount of grant which the Government plans to make available, and the basis of its allocation between authorities, will continue to be subject to approval by the House of Commons. The present Rate Support Grant Reports are cumbersome documents. It is difficult, especially for those who are not experts in the field, to pick out from the mass of material the elements that are crucial in determining how grant is apportioned. The content of these Reports has to meet requirements set down in primary legislation so there is little, if any, scope for simplifying them under the present arrangements. The proposed new grant system is in many ways simpler than block grant. This should automatically mean that the statutory documents can be simpler. But the Government also intends to look again at the way in which details of each year's grant settlement are presented to Parliament for approval, with the aim of adopting a form of presentation that will make it easier to identify the main principles which are to be decided and on which the grant allocation will be based.

4.67 The Government's intention to avoid changes in authorities' grant entitlements means that there will be only one Rate Support Grant Report for each year; the system of successive Supplementary Reports will cease. If changes need to be made to the calculations set out in the main Report - for example to correct a significant error in the data used, or to adjust any service provision assessments that may be based on budgeted or actual spending - this will be done by making explicit compensating adjustments in the grant calculation for a future year.

(Version of: 21 November 1985)

Summary

4.68 Paragraph H above sets out the objectives that a new grant system should meet. The proposals outlined in this chapter would meet those objectives.

- They would be fair. Grant would fully compensate authorities for the fact that providing a standard level of service costs different amounts in different parts of the country.

- The cost of increases in spending above that level, or the benefit of reduced spending, would fall entirely on local domestic taxpayers.

- The grant system would be inherently simpler than block grant or previous systems. The government would also aim to simplify the formulae used to assess needs.

- The system would be stable. Authorities would know, before the year in question started, exactly how much grant they were going to receive. This figure would be fixed. And grant entitlements should not vary so much between years.

4.69 In the government's view, a special resources equalisation grant is unnecessary, given the proposals to pool the proceeds of the national non-domestic rate and to change local domestic taxation to a per-adult base. Ideally, the government's aim would be a system where tax bills were the same in different parts of the country for a standard level of service. Adopted without amendment, however, such a system would mean substantial shifts between areas in the burden of local domestic taxation. The government believes that such shifts are unacceptable, and envisages that special arrangements would be necessary to avoid excessive changes in average domestic tax bills for each local authority as a result of the introduction of the new system.

4.70 This would mean that average tax bills in different authorities would continue to vary for a standard level of service. But it would still enable the change to the fairer distribution of domestic taxation <u>within</u> authorities resulting from the move to the community charge to take place. And it will still ensure that every £1 increase in local authority spending would be met entirely from the domestic taxpayers of the authority and every £1 saved would reduce the local tax burden by the same amount. The aim of ensuring that the grant system contributes to local accountability would be met.

ANNEX C: THE PRESENT LOCAL GOVERNMENT FINANCE SYSTEM: A SUMMARY

LOCAL AUTHORITY INCOME AND EXPENDITURE

C.1 In the United Kingdom, responsibility for public administration and provision of services is divided between local and central government. Local government is responsible for about 27% of total public expenditure. In England local government spent about £39bn in 1984/85. The total of local authority expenditure can be divided into three main types:

Current expenditure (77%) - spending on running costs, such as salaries;

Capital expenditure (15%) - spending which creates tangible assets such as houses; and

Interest payments on loans (8%).

C.2 Local authorities have two main sources of income - rates and central government grants. Other sources of income include money received from services such as school meal charges and bus fares, from housing rents, and from the sale of assets such as council houses. Local authorities can also borrow from central government or the private sector to finance expenditure. The following table shows the components of local authorities' income in 1984/85.

Sources of local authority income: England 1984/85

Rate support grant	22%
Other government grants and subsidies	18%
Non-domestic rates	16%
Domestic rates	11%
Sales, fees and charges	8%
Capital receipts	6%
Borrowing	5%
Rents	4%
Other	10%

C.3 There are two main tiers of local government in each area. The distribution of responsibility for services between these tiers varies, but overall the pattern of local authority expenditure by service is as follows.

Local authority capital and non-capital expenditure by service: England 1981/82

Education	37%
Housing	22%
Local environmental services	13%
Law, order and protective services	10%
Roads and transport	8%
Personal social services	7%
Other	3%

RATES

C.4 In each area the lower tier authority - district or borough council - is the rating authority. This means that they issue rate demands and collect the rate payments. Upper tier authorities, like county councils, issue precepts. A precept is a demand for a specified amount which the rating authority has to collect on the upper tier authority's behalf. The precept is added to the rating authority's own rate, collected with the rating authority's rate, and passed on to the upper tier authority.

C.5 When the rating authority fixes its rate and budget for the coming year, it first estimates how much it will spend in that year. It then deducts the amount of grant it expects to receive from the government, and its income from other sources. The balance left over is raised from local ratepayers. To calculate how much each ratepayer should pay the council first estimates what a rate of 1p would produce. This is called the penny rate product. The penny rate product is reached by multiplying the total rateable value of the council's area by 1p:

Penny rate product = rateable value x 1p.

C.6 The Council then divides the amount it needs to raise from ratepayers by the penny rate product. The end figure reached is the rate in the pound which has to be levied. This is called the rate poundage.

$$\text{Rate poundage} = \frac{\text{expenditure - block grant}}{\text{penny rate product}}$$

For domestic properties, the domestic rate relief grant (18.5p: see paragraph C.11) needs to be substracted from the rate poundage.

Domestic rates bill = (rateable value x rate poundage)
+ county precept
- domestic rate relief grant

CENTRAL GOVERNMENT GRANT

C.7 Each year the government decides on its view of what the level of local government spending should be in the following year. It then decides how much of the spending to be funded from revenue should be met by central government grant. (There are separate arrangements for controlling the total of capital spending, whether financed from revenue or from borrowing - see paragraphs C.50-C.52 below).

C.8 Central government grant, which is known as Aggregate Exchequer Grant (AEG), consists of three elements - specific grants, supplementary grants and rate support grant. Specific and supplementary grants are paid in aid of a specific service or projects. Examples are the Urban Programme, derelict land grant, police grant and transport supplementary grant. Rate support grant, as the name suggests, is a non-specific grant to subsidise spending which would otherwise have to be financed by ratepayers. In 1985/86 the Government's preferred level of local government spending was £[redacted]bn. They decided that [redacted]% of this would be met by AEG. 20% of the total of AEG would be paid as specific and supplementary grants, and 80% as rate support grant.

RATE SUPPORT GRANT

C.9 Rate Support Grant is paid in support of net revenue spending (ie spending on wages, salaries, goods and services, debt charges and revenue contributions to capital projects, less income received from other sources). This is because there is no need for the Government to support spending which is already being financed from such sources as specific grants, or fees and charges. Confusingly, this net expenditure is referred to in the relevant statutes as total expenditure (that is, the "total expenditure" for rate support grant purposes).

C.10 Rate Support Grant is made up of two elements: domestic rate relief grant and block grant. It is paid to local authorities in thirty-eight instalments during the financial year.

C.11 Domestic Rate Relief Grant is by far the smaller of the two elements of Rate Support Grant (about £700m out of £11.8bn in 1985/86). It has been paid to authorities in every year since 1973 to reduce the effect of the revaluation in that year on the level of domestic rates. In England the rate of payment has for a number of years been at 18.5p in the £.

C.12 Block grant makes up by far the largest part of Rate Support Grant. The aim of the Block Grant sytem is first to compensate for differences in the cost to authorities of providing a standard level of service (for example, because of different social, economic and geographic characteristics) and second to compensate for differences in resources. Authorities' resources are measured in terms of the rateable value of properties in their area, which in turn reflect the relative value of property in different parts of the country. In other words, block grant is distributed so as to ensure that a ratepayer in one area which may have low rateable values but considerable spending needs only has to pay the same rate in the £ for a given standard of service as a ratepayer living in another area with high rateable resources but low spending needs. This process is known as 'equalisation'.

C.13 It is worth noting that it does not equalise rate bills since the rateable value of a similar property will vary throughout the country.

C.14 In order to achieve this aim, the Government has to calculate two things - a Grant Related Expenditure and Grant Related Poundage for each authority.

C.15 The Grant Related Expenditure (GRE) is an estimate of the overall costs to an authority of providing a standard level of service. It is calculated for each authority taking into account variations in local circumstances. Each authority's GRE is built up from a number of components relating to the different services the authority provides. But it is the overall GRE for each authority which is used as a basis for distributing Block Grant. The amount actually to be spent on each service remains a matter for the individual local authority to decide.

C.16 For most services, the two main factors in the GRE formula are the number of people for whom the service is provided (for example, the number of primary school children) and the number of units of service which have to be provided (for example the number of premises from which refuse has to be collected).

C.17 In some cases a further set of factors has to be taken into account where these seem likely to influence the cost of providing a service. These include such considerations as a scattered population or a concentration of social problems or substandard housing conditions. London authorities also receive some allowance for higher costs - for example, London weighting payments in salaries.

C.18 Since GREs are intended to be an objective assessment of the need for spending they are not usually based on the actual expenditure by the authority on a particular service. However, in a small number of cases where an authority has no choice about how much to spend (for example, mandatory students' grants) the GRE is based on actual spending.

C.19 The total of the GRE figures for all authorities is calculated to fit in with the Government's overall spending plans for local authorities.

C.20 Each authority's GRE assessment will change from year to year to reflect changes in the way GRE components are claculated and to incorporate new data.

C.21 The Grant related poundage (GRP) for an authority determines how much of its spending should be met from rates and how much from Block Grant. The GRP for authorities as a whole is calculated by dividing the amount of spending by local government as a whole in government plans by the rateable value for all authorities, after deducting the total of block grant which is to be made available.

C.22 The national GRP, which changes from year to year, is divided between the two tiers of local government in any area in proportion to the functions they carry out. For example if the national GRP were set at 200p, in shire county areas where the county provides the bulk of services, the GRP for the county would be about 176p and for the district council about 24p.

HOW BLOCK GRANT IS CALCULATED

C.23 Block grant is paid to make up the difference between what authorities are assumed to raise by charging ratepayers at the level of their GRP and their total expenditure. This can be summed up like this:

Block Grant = Total Expenditure - (GRP x rateable value)

C.24 In practice a council with high rateable value will be able to raise more from a rate set at the GRP than a council with low rateable values. For the same level of spending in relating to its GRE, the low rateable value council will receive more Block Grant. This achieves the objective of equalising differences in authorities' rateable resources.

C.25 Most authorities do not spend at their GRE. If an authority's spending rises above its GRE figure, so the amount it is assumed to raise from its ratepayers (its GRP) rises according to a standard tariff. Conversely, if its spending falls, its GRP also falls. This is intended to increase local accountability by making the extra local cost of extra spending apparent to ratepayers.

C.26 This tariff is known as the Block Grant Schedule.

C.27 For 1986/87 it is proposed that the amount authorities are assumed to raise from their ratepayers (GRP) should increase by 1.1p for every £1 per head of expenditure above GRE. Of course, the figure decreases by the same amount as expenditure falls.

C.28 The amount an individual authority is assumed to raise from its ratepayers is therefore calculated like this:

$$GRP = GRP^{*} + 1.1p \left(\frac{\text{Total expenditure} - \text{GRE}}{\text{population}} \right)$$

*the GRP for that kind of authority spending at GRE.

C.29 This pressure against higher spending increases above certain levels which are known as the <u>thresholds</u>. The first threshold is set at 5% above GRE. Above that level the assumed local rate will increase by 1.3p for every additional £1 per head of spending. Above the second threshold (10% above GRE) the assumed local rate will increase by 1.5p.

C.30 The diagram below illustrates how this works.

THE BLOCK GRANT SCHEDULE: ENGLAND 1986/87

C.31 The practical effect of this schedule is that for the vast majority of authorities, their grant <u>decreases</u> as their spending rises, and vice versa.

C.32 This is because almost all authorities, except those with very low rateable values per head of population, can raise more than £1 per head by charging ratepayers the additional 1.1p (or 1.3p or 1.5p above the threholds) which it is assumed they will raise in order to finance each additional £1 per head of extra spending. In order that the equalising effective of Block Grant continues to operate the additional sum is <u>subtracted</u> from the authority's grant entitlement. Otherwise the authority would be able to take advantage of its higher rateable values.

C.33. To take an example:

An authority has a rateable value of	£50 m
It has a population of	500,000
It increases its spending by	£500,000
=	£1 per head
It is therefore assumed to raise an additional	1.1p
from its ratepayers which will raise	50 m
x	1.1p
=	£550,000

Its block grant is therefore reduced by £50,000: the £550,000 raised less the £500,000 it wants to spend.

C.34 This effect is often referred to as a negative marginal rate of grant. Some authorities have such high rateable values per head that they would receive no block grant whatsoever.

C.35 New information about authorities' spending is constantly being received by the Government. The initial RSG announcement for the coming year, which is know as the Settlement, is made before authorities have set their budgets. Final audited figures for spending in any one year may not be received until as long as 2 years after the end of the financial year concerned.

C.36 Adjustments to grant entitlements are therefore made in a series of rate support grant Supplementary Reports.

C.37 The amount of Block Grant available for distribution is a fixed sum set by the Government in the Public Spending Plans. In order to match the claims for grant to this sum, the GRP for spending at GRE may have to be adjusted in a Supplementary Report in order to reduce or increase each authority's grant entitlement. This kind of adjustment is called close - ending.

C.38 Multipliers are a device for adjusting an authority's grant entitlement. They are used mainly to produce safety nets or caps which prevent authorities from having large grant changes between years. Safety nets, for example, are used to limit the effect of year on year changes in the method of calculating the GRE where these would otherwise cause large grant losses.

C.39 The multiplier works by multiplying the product of the authority's GRP and its rateable value either to increase or reduce the amount the authority is assumed to raise from its ratepayers before block grant is paid. The grant of an authority in this position is calculated like this:

Grant = total expenditure - (GRP x rateable value) x multiplier

C.40 London is subject to the normal Block Grant distribution arrangements. However, there are two differences in the treatment of London to take account of London's high rateable values.

C.41 If the normal equalising effects of the Block Grant system were to apply, these higher rateable values would considerably reduce London authorities' Block Grant. Part of the rateable value of each London authority is therefore discounted when its block grant is calculated, by the use of a special multiplier. The discount is higher in Inner London because of particularly high rateable values there.

C.42 As a further measure of equalisation, the central London authorities with the highest values make payments to other London Boroughs. This is the London Rate Equalisation Scheme (LRES).

EXPENDITURE GUIDANCE/TARGETS

C.43 Between 1981/82 and 1985/86 the government superimposed a separate system for controlling local government spending on the basic block grant system. This was done by giving every local authority an expenditure guidance or 'target'. If an authority spent more than its target, it forfeited grant on the basis of a fixed tariff. Grant lost in this way was known as holdback or penalty and was retained by the Treasury. The Secretary of State can exempt some spending from the penalty system. These exemptions are called disregards, because the spending is disregarded when holdback or penalty is calculated. So if an authority spends £10.1m against a target of £10m, but spent £100,000 on items for which expenditure was disregarded, it would not incur holdback.

C.44 Although targets have now been abandoned, their effects will continue to be felt in the implementation of holdback and disregards until the books are closed for the years during which targets were issued.

RATE LIMITATION

C.45 Selective rate limitation or 'rate capping' was introduced by the Rates Act 1984. Rate capping has enabled the Secretary of State to concentrate efforts to reduce high spending on a small number of the highest spending authorities. It protects ratepayers in these areas from excessively high rate demands, because the Secretary of State sets a maximum on the rate in the pound which a rate capped council can raise.

C.46 Every summer, a number of authorities are selected for rate capping in the following financial year. To be selected for ratecapping, an authority's spending has to meet three criteria. First, it has to be 'excessive'. Second, it has to be higher than a level set by the Secretary of State. This level is currently fixed at £10.6m, so that councils whose spending is low in absolute terms are excluded from rate capping. And thirdly, an authority's spending has to be higher than its GRE.

C.47 When they are selected, councils are notified of their expenditure levels (ELs). The EL is the sum the Secretary of State assumes the council will spend in the following year.

C.48 Councils have the right to apply to the Secretary of State for a higher EL. This process is known as redetermination. If a council makes an application for redetermination, the Secretary of State can raise the EL, reduce it, or leave it unchanged.

C.49 When the expenditure level has been decided, the rate limit is calculated at a level which will finance the EL. The two other main factors in making this calculation are an authority's block grant entitlement and its level of reserves. The Secretary of State first calculates how much grant the authority will get for spending at its EL. He then decides how much of the rest should be raised from ratepayers, and how much (if any) from reserves. The figure arrived at is then divided by the penny rate product to produce the provisional rate limit.

$$RL = \frac{(EL - BG)}{PRP}$$

Councils subject to rate limitation may not raise a rate in the £ higher than their rate limit.

CAPITAL EXPENDITURE CONTROLS

C.50 Each year central government decides on the overall level of local authority capital expenditure which it believes to be compatible with the national economic interest. Each authority may spend an amount, known as its prescribed expenditure allocation, notified by central government, together with a proportion of the proceeds of asset sales and of repayments of grants and advances made by the authority, and the profits of trading undertakings.

C.51 In deciding on the total of allocations to be divided between authorities, central government has regard both to the national total of spending which it wishes to see and to the extent to which authorities are able to add to their allocations from the other resources mentioned. Each authority receives allocations in up to six blocks, covering Housing, Education, Transport, Personal Social Services, Urban Aid Services and Other Services, depending on the range of services for which it is responsible. There is no obligation on an authority to match expenditure to allocations: authorities may transfer allocations both between blocks and between authorities. There is also a limited facility to carry over into or anticipate from the following year's allocation.

C.52 Authorities have freedom in choosing how to finance expenditure within the permitted level. Their borrowing for capital purposes is controlled through a block approval issued by central government, but the amount of the approval is broadly equal to the authority's total allocations for the year, so that it should not serve as a constraint. They can also use the proceeds of asset sales and repayments of grants and advances; contributions from the rate fund; savings in special funds; and such grants as they may receive from central government, public bodies like the Sports Council, the European Community and the private sector.

APPENDIX C1

THE TIMETABLE FOR RATE SUPPORT GRANT AND RATE LIMITATION

RATE SUPPORT GRANT

July	-	Provisional RSG announcement, usually comprising totals of expenditure and grant to assist local authorities in advance planning for the following year.
		First Supplementary Report for the current financial year, in which adjustments to grant are made on the basis of budget information and grant abatement (or holdback) is implemented.
		Final Supplementary Report for the financial year three years earlier, to 'close the books' in the light of audited outturn expenditure information.
December	-	RSG settlement for the coming financial year, in which Government plans for local authority spending, the total of AEG, and individual authorities' grant-related expenditure are announced.
		Second Supplementary Report for the previous financial year, to adjust grant and holdback to reflect provisional information.
January	-	December RSG reports debated and approved by the House of Commons.
April	-	Payments of grant for the current year start.

RATE LIMITATION

end July	-	Report laid before the House of Commons which lists selected authorities and explains the criteria for selection.
end July	-	Selected authorities are notified of their expenditure levels (ELs).
October	-	Last opportunity to apply for redetermination of ELs.
December	-	The Secretary of State announces this decision on redeterminations.
December	-	Selected authorities are notified of proposed rate limits on the basis of the original or a redetermined EL.
mid-January	-	Last opportunity to accept or comment on rate limits.
February	-	Rate limits confirmed.