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FROM: R FELLGETT

DATE: 5 May 1988

for prep

- 1. MR POTTER *BHP 515*
- 2. CHIEF SECRETARY

- cc Chancellor
- Sir P Middleton
- Mr Anson
- Mr Phillips o/r
- Mr Hawtin
- Mr Turnbull
- Mr Gieve
- Mr Burns o/r
- Mr Call

Ch
I have some doubts. In view of importance, do you want to hold a meeting? (possibly with AJCE in guest appearance)
AA

1989-90 RATE SUPPORT GRANT SETTLEMENT FOR ENGLAND

My submission of 7 April discussed the following broad objectives for the 1989-90 RSG round:

- (i) a useful precedent before the Community Charge system starts in 1990-91 in England;
 - (ii) a firm settlement which generates, in practice, as much pressure on local authorities to moderate their spending as the settlement for 1988-89 did.
2. As you requested at your meeting with us, I now attach:
- (i) a matrix showing options for changes in expenditure provision and AEG, and the resulting grant percentages;
 - (ii) a draft of a letter which you might send Mr Parkinson immediately after a preliminary meeting with Mr Ridley.

The Matrix

3. I am afraid that some of the numbers have changed a little, as we have updated them. They are, however, still provisional as DOE will not have comprehensive information about local

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authority budgets for 1988-89 until later in May. Nor have the calculations and underlying assumptions been discussed with DOE officials.

4. Option D11 in the matrix is, we guess, the DOE objective. This increases provision, compared to local authorities own budgets, by a little more than the forecast GDP deflator, to allow for Community Charge preparation costs. With an unchanged grant percentage of 44.5% (after adjusting for the transfer of polytechnics) AEG is increased by £1,035 million.

5. The Treasury objective for the outcome of the negotiations which you discussed with us at your earlier meeting is around option D4 - an increase in provision of £1,500 million over the PEWP baseline, and an increase in AEG at settlement of £580 million over the 1988-89 settlement. Provision would then rise by a full 9% compared to the equivalent PEWP figure for 1988-89, and the increase of about 4.4% compared to local authorities' own budgets would (just) be credible. AEG would rise by £1,090 million compared to outturn for 1988-89. But on the assumption the underclaim of £510 million for 1988-89 would be repeated in 1989-90, the actual increase in grant would also be £580 million. That is in practice much the same as the actual increase for 1988-89, and it will therefore generate similar pressures on local authorities to control their expenditure.

6. You thought your opening position in E(LA) should be tough. You could therefore argue from the plans already agreed and published in the latest PEWP. This is option A2. You could decline to make any increase in provision as a result of local authorities again overspending the Government's plans. And, although there is as yet no forward plan for AEG, you could either argue that the 3.5% growth in provision between 1988-89 and 1989-90 in the last PEWP implied a similar percentage growth in AEG; or (roughly equivalently) that you would be prepared to see AEG, like provision, held broadly level in real terms. In cash at settlement, a 3.5% increase is £450 million. The grant percentage might even rise slightly - our calculations give 44.8% - demonstrating that you are not seeking a cut in the grant percentage for its own sake; rather, you are seeking to settle

*Grant %
43.1*

*I think this is losing tactics:
a 44.8% grant percentage would be a cut in
the grant percentage to established level.
even if we have to retreat later*

Our opening bid should be a cut in

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on a reasonable increase in grant and the percentage then depends on local authorities' own spending decisions.

7. The PEWP plan seems, however, a little difficult to defend even as an opening position. The arguments against it include:

(i) the increase of 3.5% was based on the then GDP deflator for 1989-90, which was increased in the FSBR to 4%;

(ii) no increase in the PEWP provision would mean planning on a cash cut in LA spending compared to their own budgets for 1988-89, which would be credible neither to the TCSC nor at Judicial Review;

(iii) although the increase in AEG at settlement would be £960 million compared to outturn for 1988-89, the grant underclaim with such an unrealistically low level of provision would be likely to rise from about £510 million in 1988-89 to around £1,250 million in 1989-90, leaving LAs at outturn with less grant in 1989-90 than in 1988-89.

The Cabinet Office will be able to advise Mr Parkinson of these points. I therefore suggest that your opening position should be to stick as closely as possible to the published plans.

8. When you write to Mr Parkinson, there is no need to quantify your opening position too precisely. You can consider exactly what it should be, in figures for AEG and provision, nearer the first meeting of E(LA). However, on provision, I expect that when you quantify your position you will need to depart from the PEWP plan at least as far as a round $\frac{1}{2}$ billion claim on the Reserve - row B - to avoid a cash cut on LAs budgets for some services. Indeed, depending on your feel for the tactics, you might go as far as a £1 billion claim on the Reserve - row C - to offer the prospect of a little cash increase on LA budgets for all services. On AEG, you might go as far as an increase in line with general inflation - column 3; or

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propose a small real terms cut of $\frac{1}{2}\%$ - column 2. The four possibilities are therefore B2-3 and C2-3; all would give you scope for further concessions on both AEG and provision within the objective.

9. My earlier submission suggested that you might make Mr Ridley a "take it or leave it" offer at a preliminary meeting, if he indicates that he would be prepared to look at options that do not simply maintain the grant percentage. Any such offer will need to be very close to the objective to stand any chance of success, but you will wish to leave a small margin for negotiation. The offer could therefore be: a claim on the Reserve of £1,250 million; and an increase in AEG, slightly above forecast inflation, of $4\frac{1}{4}\%$ to help pay for the Community Charge. (This falls between rows C and D, and between columns 3 and 4; the grant percentage is about 43.3%.) You could easily raise it to an increase in AEG in line with inflation plus the cost of introducing the Community Charge, if Mr Ridley would settle for that.

10. It is also worth commenting on an apparent compromise like option C7. That would increase provision by £1 billion, with a corresponding transfer from the Reserve, leading to provision for 1989-90 in the next PEWP some 7.2% higher than the equivalent figure for 1988-89 in the last PEWP. And it would involve an increase in AEG at settlement of £775 million (which, because provision would be lower than under the D options, would lead to higher grant underclaim and an actual increase in AEG at outturn of around £575 million, in line with the objective). The settlement grant percentage would be 44.4%, very close to 44.5% in 1988-89.

11. The difficulty with such an option is that the increase in provision over local authorities' own budgets for 1988-89 would be just 2.7%. After reasonably realistic allowance had been made for expenditure under central government control - especially police pay and manpower and teachers' pay - a growth of only 1% or 2% over local authority budgets would be left for the bulk of services. Even if colleagues like Mr Baker

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and Mr Moore could accept this, it could be liable to legal challenge. This illustrates, of course, the nub of the problem with the grant percentage approach, as you might point out to Mr Ridley. Because local authorities have overspent by over £1 billion in 1988-89, an equivalent increase in provision may be needed for 1989-90, but that is no reason to finance half the 1988-89 overspend one year in arrears.

12. Nevertheless, if all your colleagues on E(LA) are adamant that the grant percentage must be maintained you will wish to leave options close to C7 open, as a last fallback. That would probably mean agreeing to a claim on the Reserve between the C and D options, and a correspondingly higher increase in AEG, rather worse than the objective.

The Letter to Mr Parkinson

13. The draft letter sets out fairly fully the main arguments for a firm approach to the RSG settlement, and in broad terms your negotiating position. It also touches on the counter-arguments. And it hints that you would be prepared to modify your position a little in discussion; it could undermine the credibility of the main argument to leave out such a hint, although you will wish to avoid any suggestion that you could modify your position very significantly.

Next Steps

14. You planned to have a brief word with Mr Parkinson, and then a meeting with Mr Ridley followed by your letter to Mr Parkinson. Recent events have not, unfortunately, improved the climate for a discussion. In the Community Charge debates in the House several Government supporters called for reductions in prospective Community Charges, financed by increases in grant (or by direct funding of education, which is equivalent). Only Mr Heseltine drew attention to the public expenditure counter-argument. The district council elections today may also affect the climate.

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15. Cabinet Office are considering a first meeting of E(LA) in the week beginning 23 May, as Mr Parkinson is abroad after the Whitsun Bank Holiday until about 14 June. DOE officials have just told us that, after further discussion with their Ministers, they hope to show us a draft of Mr Ridley's paper next week. A second E(LA) meeting could not take place until the second half of June, which would leave time for further work and bilateral contacts in the first half of June.

16. I therefore suggest that it would be preferable to meet Mr Ridley first towards the end of the week beginning 9 May. That would leave time for a further discussion, if appropriate, before E(LA)'s first meeting.

17. If you are broadly content with the line of argument and the negotiating position in the draft letter, we will prepare more detailed briefing for a meeting with Mr Ridley accordingly.

Robi Fellgett

R FELLGETT

SETTLEMENT GRANT PERCENTAGES, AT VARIOUS LEVEL OF AEG AND EXPENDITURE PROVISION

% Increase in AEG over 1988-89 settlement (cash increase in AEG at settlement:
cash increase in AEG at settlement over grant actually being paid in 1988-89)

	1	2	3	4	5	6	7	8	9	10	11
<u>Claim on the 1989-90 Reserve</u>	3.0%	3.5%	4.0%	4.5%	5.0%	5.5%	6.0%	6.5%	7.0%	7.5%	8.0%
(% change on 1988-89 PEWP provision: % change on LA's own 1988-89 budgets)	(£390m : £900m)	(£450m : £960m)	(£515m : £1,025m)	(£580m : £1,090m)	(£645m : £1,155m)	(£710m : £1,220m)	(£775m : £1,285m)	(£840m : £1,350m)	(£905m : £1,415m)	(£970m : £1,480m)	(£1,035m : £1,545m)
A. £0m (+3.5% : -0.9%)	44.6	44.8	45.0	45.2	45.5	45.7	45.9	46.1	46.3	46.5	46.7
B. £500m (+5.3% : +0.9%)	43.8	44.0	44.3	44.5	44.7	44.9	45.1	45.3	45.5	45.7	45.9
C. £1,000m (+7.2% : +2.7%)	43.1	43.3	43.5	43.7	44.0	44.2	44.4	44.6	44.8	45.0	45.2
D. £1,500m (+9.0% : +4.4%)	42.4	42.6	42.8	43.1	43.3	43.5	43.7	43.9	44.1	44.3	44.5

NB: (1) Settlement grant percentage for 1988-89 = 44.5%

(2) Actual grant percentage for 1988-89 (after overspending and grant underclaim) = 41.2%

97.5% had

Tsy 'Objective'

DVE 'Objective'

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DRAFT LETTER TO MR PARKINSON

1989-90 RATE SUPPORT GRANT SETTLEMENT FOR ENGLAND

I mentioned to you a little while ago that I was planning to discuss with Nicholas Ridley the approach that we might take to the 1989-90 Rate Support Grant settlement, before E(LA) begins its work. I thought it would be helpful to you to let you have this personal note of the approach I plan to take [, and the progress that I have made with Nicholas].

2. The rapid rate at which local authority current spending is increasing causes me quite considerable problems. As you know, we are pledged to reduce the proportion of national income that is absorbed by public expenditure. Overall, taking central and local government together, this is being achieved. But that achievement is in spite of the record of local authorities. We estimate that over the three years to 1988-89, local authority current spending will have grown by almost 30%, compared with inflation of 13%. The resulting real growth in expenditure is significantly higher than growth in the economy as a whole. Such rapid increases in local authority spending can therefore only be accommodated within our overall objective by taking a much more restrictive attitude to central government expenditure programmes; they have to more than offset the increasing share of GDP pre-empted by local authorities.

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3. A good deal of the problem lies with local authority pay and manpower. We could have accommodated priorities like the growth in police numbers and their generous formula pay rises, and the high pay award for teachers in 1987. But double figure pay increases like those that the local authorities - led on the management side by our opponents - have conceded to manual workers have been a major element fuelling the increase in expenditure. Such increases are also hardly in the wider best interests of the economy and the control of inflation. Local authority manpower has also been increasing recently (despite falling school rolls, which is the major demographic pressure on authorities) in sharp contrast to the achievements on manpower of central government.

4. In many ways, the position is worse than the real increases in local authority expenditure which we faced in 1979-80 and 1980-81. Our answer then was the new block grant system, targets for expenditure and penalties for exceeding them, and a series of tough RSG settlements with very limited cash increases in Aggregate Exchequer Grant over several years. Only as those financial pressures on local authorities were relaxed in 1986-87 and 1987-88 have we seen such a rapid rate of increase in their expenditure.

5. Part of the answer to the present problem is the Community Charge and the other changes in local government finance which will go with it, accompanied by a firm attitude to increases in grant. But I would not want to be complacent

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and wait until 1990. On the contrary, I am encouraged by the fact that the firmer RSG settlement for 1988-89 (at outturn, after allowing for grant held back in both years, the increase in AEG is likely to be a little over £½ billion, compared to nearly £1 billion for 1987-88) seems to have contributed to a modest slow-down in the rapid rate of increase in local authority expenditure. But the results are by no means as good as those achieved in the mid-1980s, when real cuts in AEG each year were the norm.

6. For 1989-90 I would therefore like to build on the progress in 1988-89, and give local authorities stronger financial incentives to behave responsibly. I do not, however, plan to propose to colleagues that we reintroduce the target and penalty system. I recognise the difficulties that could cause on our own backbenches. Nor do I intend to propose anything that would require further legislation; I am sure the business managers could do without any more controversial local government finance Bills.

7. I will therefore propose that we should stick as closely as possible to our agreed and announced plans for local authority expenditure provision, which were contained in the last Public Expenditure White Paper. Those allowed for increases in line with inflation (then assumed to be 3.5% in 1989-90). We must not be pushed into big increases in the plans simply because local authorities have overspent so badly again in 1988-89.

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8. Similarly, we should increase Aggregate Exchequer Grant by no more than is needed to cover general inflation; and, indeed, I see merit in the signal that a small real cut in grant would give to local authorities. (I will also argue for the minimum increase in GREs, or assessed spending needs, to avoid any inappropriate signals. But that is a more technical point.)

9. It is essential that we should not again fall into the trap of increasing AEG in proportion to any increase in provision, to finance part of the overspend in the earlier year within the higher level of provision. That would be the inevitable effect of tying ourselves to the idea that grant should be some fixed percentage of local authority expenditure provision. I recognise that we did this for 1987-88 and, with some modifications, for 1988-89. It was widely welcomed by local authorities. I am not surprised. They know that it leaves the initiative with them to decide pay increases and expenditure levels, in the knowledge that the Government will, with only a year's delay, come up with almost half the necessary cash. To allow local authorities to dictate to us the level of taxpayers' subsidy in this way is particularly damaging on the pay front, where we have repeatedly said that we will not finance excessive pay awards agreed by the local authorities and their unions. I am anxious to maintain our credibility following several excessive awards recently.

10. Some might argue that a firmer settlement for 1988-89 than for 1987-88 would lead to unacceptable rates

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increases. But rates increases in 1988-89 are likely to average around 7%, little more than in 1987-88, despite the lower increase in AEG. And the experience up to 1985-86 also shows that a firm stance on grant leads, not to a rates explosion, but to more moderate expenditure increases and hence acceptable rates rises.

11. I have discussed this with Nicholas Ridley. [To be added.]

12. I hope it is helpful to you to set out my position in this way. Obviously I will consider further the points [which Nicholas has put to me, and others] which other colleagues may wish to put in E(LA). I am very much aware of the priority that should be attached to policies involving local authority expenditure, such as education reform, the police, and the launch of the Community Charge. But am bound to warn you that I have only limited room for manoeuvre. I must also bear in mind our priorities within central government expenditure, including the health service, social security and defence. Within our overall objective that public expenditure should form a decreasing proportion of national income, a firm stance towards local authority expenditure as a whole is essential.

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CST
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1. MR POTTER *BHP 11/5*
2. CHIEF SECRETARY

FROM: R FELLGETT

Date: 11 May 1988

cc: PS/Chancellor
PS/Sir Peter Middleton
Mr Anson
Mr Phillips
Mr Hawtin
Mr Turnbull
Mr Call

1989-90 RATE SUPPORT GRANT SETTLEMENT FOR ENGLAND

The matrix attached to my submission of 5 May refers primarily to options (labelled A-D) for claims on the 1989-90 Reserve to increase provision beyond the £27.70 billion allowed for in the latest public expenditure White Paper; and to options (numbered 1-11) for percentage increases in Aggregate Exchequer Grant for 1989-90 at settlement, compared to AEG in 1988-89 at settlement.

2. You asked for further quantitative information about the starting point of the E(LA) discussions. This is attached at Annex A. The numbers are all consistent with my earlier submission (of 5 May). I will update them when we have been able to discuss the figuring with DOE, probably next week.

3. You also asked about the **best possible settlement for 1989-90 which could be based on an unchanged grant percentage.** The calculations are at Annex B.

4. White Paper provision for "relevant current" expenditure for 1989-90 is closely related to the settlement assumption about all relevant expenditure, which in law (and hence to an extent politically) has to be defended as the Government's best estimate of what local authorities will (not should) spend. I think the **absolute minimum increase over local authorities actual budgeted expenditure in 1989** which could therefore be defended is 3%. **Even that is perhaps optimistic:** it is a 1% real terms cut (on the FSBR GDP deflator) after several years in which local authority expenditure has shown substantial real

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increases and arguably does not take account of the priorities like education and the introduction of Community Charge.

5. With a 3% uplift, the resulting claim on the Reserve would be £1.1 billion, and the increase in AEG at settlement would be £880 million or 6.8%. In my view, these figures, and the underlying endorsement of local authorities' pay decisions and overspending in 1988-89, are sufficiently unattractive to make it worthwhile attacking the concept of an unchanged grant percentage, even though that proved ultimately unsuccessful last year.

6. There is a third option which you might wish to consider. You might argue that you are perfectly happy to apply an unchanged grant percentage to what local authorities should spend; but you would not take account of what they actually spent in the past or future. Under this approach, you would argue that AEG should be a fixed percentage of aggregate GRE, which is the Government's assessment of what local authorities "need to spend". You would then argue that GREs should increase in aggregate by only about, say, 4½% (slightly more than inflation to cover Community Charge preparation costs), and AEG should similarly rise in proportion by 4½% (or by about £580 million).

7. The potential drawbacks of this approach are, however:

- (i) Mr Ridley has defended the last two settlements by referring to the fact that AEG has remained (roughly) a fixed percentage of relevant expenditure provision. He will have some difficulty defending the next one in terms of an unchanged grant percentage, because the polytechnics transfer has anyway reduced that percentage - local authority officials made that very clear to us and DOE earlier today. He would have even more difficulty if the defence was, in fact, in terms of a different percentage of something else. I guess that he is therefore unlikely to see attractions in this.

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(ii) Even if Mr Ridley is sympathetic to the view that AEG should be a percentage of what the Government believes authorities should spend, it may be difficult to persuade colleagues with expenditure responsibilities (eg Mr Hurd or Mr Baker) that "need to spend" is rising by little more than the rate of inflation. Local authorities have probably overspent aggregate CRE for 1988-89 by around £2 billion. Colleagues may well want to take some account of that, even though the strict logic suggests they should not, before adding on percentages for general inflation or any other specific items. There is therefore a danger that the approach would, in E(LA), turn out to be quite expensive.

On balance, I doubt if this an option worth running for 1989-90; but as Mr Potter's separate submission argues, it may be more useful under the new Community Charge regime.

Hugh Burns

P.P. R FELLGETT

ENGLISH LA EXPENDITURE AND GRANT

		£ billion	
	1988-89	1989-90	
1988 PEWP provision for 'relevant current' expenditure	26.77 (27.53)	27.70 (28.50)	
LA's actual budgeted 'relevant current' expenditure	27.96 (28.76)		
AEG at settlement	12.94 (13.78)		
AEG at outturn after grant underclaim	12.43 (13.26)		
Grant %* at settlement	44.5% (46.2%)		
Grant % at outturn, ie at actual spending and grant levels	41.2% (42.9%)		

* ie AEG as a percentage of all relevant expenditure, including about £2.2 bn of items such as debt interest not treated as 'relevant current' (mainly also not classified as public expenditure).

Note: figures before the polytechnics adjustment are in brackets.

A GRANT PERCENTAGE SETTLEMENT

LA's actual budgeted spending on <u>all</u> relevant expenditure in 1988-89	£30,144 million
Uprated by 3%	£31,048 million
AEG at 44.5%	£13,817 million
LA's actual budgeted spending on 'relevant current' expenditure in 1988-89	£27,958 million
Uprated by 3%	£28,797 million

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FROM: BARRY H POTTER

DATE: 11 May 1988

CHIEF SECRETARY

cc PS/Chancellor
 PS/Sir P Middleton
 Mr Anson
 Mr Phillips
 Mr Hawtin
 Mr Turnbull
 Mr Fellgett
 Mr Call

Handwritten notes in red ink:
 [Whatever the agreement is, we must be able to settle it by 1990/91, the last year of the settlement. We're having a meeting next week. AA
 for a more serious line for 1990/91, settlement to 1989/90
 cc, gov
 We're having a meeting next week
 AA

RSG NEGOTIATIONS IN ENGLAND: 1989-90

I understand your meeting with the Secretary of State for Environment to discuss this year's RSG negotiations has now been fixed for the morning of Tuesday, 24 May. Yesterday I accompanied Mr Phillips to a tour d'horizon meeting with senior DOE officials; and they were rather more forthcoming about Mr Ridley's likely stance on the RSG settlement for 1989-90. Although we will brief later for the meeting, you may like to be aware now of Mr Ridley's thinking.

2. First, Mr Ridley proposes to take a very similar line to last year. His starting point will be local authorities' budgets for 1988-89 which are some 4% above the settlement spending assumption. He will argue that these aggregate budgets should be uplifted broadly in line with inflation; plus an extra amount for the costs of introducing the Community Charge; and less another small amount to allow for assumed efficiency gains. This figure, adjusted for authorities that are rate-capped, would form the provision for local authority expenditure in 1989-90. To this, he would propose to apply a broadly constant grant percentage (adjusted for the transfer of polytechnics) to derive AEG for next year.

3. This is essentially the line foreshadowed in Mr Fellgett's minute of 7 April. As you know the principal argument against it is that this approach effectively validates local authorities'

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overspending: it meets a fixed share of that overspending one year in arrears.

4. Second, Mr Ridley is apparently planning to display the likely outcome of such an RSG settlement, less in terms of the impact on rates in 1989-90, than by showing what Community Charges would have been next year. And he will go on to illustrate what Community Charges will be in 1990-91 on the basis of this settlement - clearly a critical issue for Ministers. This can be done on the basis of the proposals in last year's Yellow Booklet that:

"There will be a safety net designed to make sure that a local council will need to raise only the same amount from Community Charges in 1990-91 as it raised from domestic rates in the previous year provided that it spends the same amount in real terms in both years."

5. Mr Ridley will clearly seek to play on colleagues' fears about the starting level of the Community Charge in 1990-91 and argue that we need to put in sufficient grant now to prevent excessive charges emerging. Our argument must be that we need to get local authorities' expenditure under firmer control now; it is excessive spending that will lead to excessive charges under the new regime. We must therefore build on the limited success this year; in response to a tougher grant settlement, there has been some reduction in the growth of LA spending. We must reinforce the pressure next year.

6. Third, we took the opportunity to contrast the growth in local government expenditure with that for central government over the last few years and focussed on excessive pay increases for LA manuals, the fire service etc and resumed growth in LA manpower, as the two principal factors driving the faster rate of growth. DOE officials did not seek to deny this but pointed out that, over a longer time scale, the trends looked rather better. Nonetheless, some senior DOE officials are sympathetic to the concerns about the faster growth in manpower and pay;

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Volume Planning

and they favour a more bottom up approach in this year's RSG papers looking at unit costs, service levels and how far efficiency savings identified by the Audit Commission can be taken into account.

7. On the one hand this approach may be advantageous in focussing more attention on the unpalatable facts about manpower and pay. But on the other there is a danger that a more disaggregated approach would allow the Departments to press their case for more resources to meet service commitments. We will investigate the possibilities further: but at this stage it is doubtful whether the points about pay and manpower can be made more effectively at a service level rather than on a macro basis.

Future RSG Settlements

8. Finally - and highly relevant to this year's RSG negotiations - DOE officials gave some important indications about Mr Ridley's longer term thinking on future settlements under the Community Charge regime. He sees the foundation of future settlements as being the figures which he and Mr Howard have quoted in recent articles and discussions on the Local Government Finance Bill: that Exchequer grant (RSG and specific grants) should amount to about 50% of local government current expenditure; the proceeds from NNDR, a further 25%; with the Community Charge making up the final 25%.

9. Clearly he is seeking to entrench the fixed grant percentage approach. But he is not yet clear about what this percentage would be applied to. He sees two options: the first would be based on a target path for the Community Charge. If that approach is pursued, we would be stuck with - at best - all the present problems of a fixed grant percentage applied to LAs' actual spending including any overspending above what the Government believes is appropriate. The second approach is to apply the grant percentage to the assessed need to spend, ie broadly (with definitional differences) aggregate GRES.

10. Two conclusions seem to emerge from this. First, we must seek to break the grant percentage argument if at all possible.

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There is no reason to assume that any particular division between the costs borne by taxpayers, business ratepayers and charge payers is correct. We should strive to maintain the freedom to shift that balance; we must preserve some room for manoeuvre to take account not just of overspending but also future changes in local authority functions. Nevertheless, given Mr Ridley's clear attachment to the grant percentage and accepting that it may be seen by colleagues as having political attractions, then our second best strategy should be to ensure that any grant percentage is applied to local authorities assessed need to spend and not their actual spending. This is quite clearly consistent with the logic of the new scheme.

11. Mr Fellgett's submission of today discusses the prospects of us taking such an approach for 1989-90. I agree with his conclusion in that, on balance, it is not worth running for next year. But we should bear it in mind both as a debating point for this year and more importantly for the new system after 1990. We must avoid at all costs any idea that such a grant percentage has to be applied to whatever local authorities spend, in order to keep down Community Charges in the future.

12. We will provide briefing for your meeting with Mr Ridley by the end of next week. In the meantime we are seeking further clarification of the figures; the proposed tone and style of presentation in E(LA) papers; and Mr Ridley's likely negotiating stance.

Barry H. Potter

BARRY H POTTER