

CONFIDENTIAL

CHIEF SECRETARY

FROM: B H POTTER

Date: 5 July 1988

cc: PS/Chancellor
Sir Peter Middleton
Mr Anson
Mr Edwards
Mr Fellgett

RSG SETTLEMENT: PRESENTATION OF DOE STATEMENT

At the meeting with the Environment Secretary last Thursday 30 June, it was agreed that the quantum of grant for 1989/90 in England would be £13,575 million. That is recorded in the minutes of the meeting.

2. You will recall, however, that, first in the context of how much grant should be made available and later in the context of presentation, there was debate about whether Mr Ridley should describe some element of this total grant as grant repayment for 1987-88 and 1988-89. This repayment would reflect the normal tendency for outturn expenditure to be lower than budgetted expenditure (on which grant is paid), and for a grant repayment to LAs in respect of this to be paid out via a Supplementary Report in a later year.

3. At the meeting you accepted that Mr Ridley should have discretion on the question of presentation. We have now heard that Mr Ridley intends to present the £13,575 million for AEG as all for 1989-90. This has the advantage from DOE's point of view of keeping up the grant percentage. But I fear it has a major risk for us - that, having not given anything for earlier years, Mr Ridley will come under strong pressure to do so. Past experience suggests that once the pressure becomes strong, Mr Ridley will then seek additional grant above the £13,575 million.

4. I do not think we should underestimate the likelihood or strength of such pressure: it is the main feature of a fixed grant settlement which is open to criticism. In effect we are rewarding the imprudent and punishing good financial management.

5. But having agreed discretion for Mr Ridley on presentation, you cannot now withdraw it. Nonetheless, on balance, we recommend that you should write to Mr Ridley putting forward your own thoughts on the presentation. The line would be that, having given it further consideration you see two advantages in making it clear there is an allowance within the total for grant repayments for earlier years. (Ideally this would be an explicit sum, but at the least an acknowledgement of the basis of the grant (ie that it includes such an allowance) should be made.)

(i) The grant repayment for earlier years would clearly not be for this year and therefore not intended to support expenditure in 1989-90. Indeed some part of ^{the} ~~them~~ ^{payments} would not normally have been received till 1990. Therefore Mr Ridley could indicate that he hoped such repayments of grant would be added to balances and be available to keep down the Community Charge in 1990-91.

(ii) Without this attribution of an amount for grant repayment for earlier years, very strong pressures will build up to make even more grant available next year in recognition of prudent management for preceding years. That would be politically awkward. But having firmly if reluctantly agreed the total quantum of grant at £13,575m for 1989-90, there can be no question of adding to that - whatever the pressure.

6. If you agree, I attach a draft letter for you to send to the Environment Secretary.

Barry H. Potter

BARRY H POTTER

DRAFT LETTER TO ENVIRONMENT SECRETARY

RSG PRESENTATION

We agreed last week that the total quantum of AEG in England for 1989-90 should be £13,575 million and that you would decide how the grant settlement might best be presented. I have also been giving further consideration to presentation and, in particular, how we can most satisfactorily defend the agreement we have reached.

I see considerable advantage in describing some element within that total as being grant repayment for the earlier years 1987-88 and 1988-89, to reflect the likelihood that outturn expenditure will be lower than budgets. One option would be to identify an explicit sum - say £75m pa - within the total, as you suggested. But at the very least, we should acknowledge from the outset that there is an implicit allowance for such grant repayments within the announced total.

This form of presentation would allow us to identify part of the grant for 1989-90, as intended not to support expenditure next year, but rather as an amount which ought to be added to balances and therefore be available to keep down Community Charges in 1990-91. Moreover I am concerned, that without some explicit

acknowledgement that prudent budgetting this year and last year is being rewarded in our grant proposals, we will come under very strong pressure to make even more grant available. I must reiterate that my reluctant agreement to a quantum of £13,575 million for 1989-90 was on the basis that it would be the total cash amount for next year; there can be no question of any extra grant payments over and above that amount.

I am copying this letter to the Prime Minister, the Secretary of State for Energy and Sir Robin Butler.

CONFIDENTIAL

FROM: BARRY H POTTER

DATE: 5 July 1988

CHIEF SECRETARY

cc PS/Chancellor
Sir P Middleton
Mr Anson
Mr Edwards
Miss Peirson
Mr Fellgett

RSG SETTLEMENT: WALES

Mr Fellgett and I discussed the RSG settlement for Wales with Welsh Office today. At official level we reached - with considerable difficulty - a provisional understanding which we agreed to put to our respective Ministers. The proposal is for a fixed grant settlement for 1989-90 of £1316 million; that is equivalent to the same percentage increase in AEG for 1988-89 as in England, plus a further £5 million to reflect "special circumstances in Wales".

2. The Welsh Secretary wrote to you on 1 July accepting the principle of a fixed grant settlement but arguing that special circumstances in Wales - specifically the low rateable base - required extra grant in order to be consistent with broadly comparable rate increases in 1989-90 to those projected for England, for broadly comparable levels of spending. I understand that Mr Walker's letter was discussed at the Prime Minister's meeting on Monday and that the inclination was not to give much if any recognition in higher grant for these special circumstances.

3. In the morning session, Welsh Office argued for grant of £1342 million for 1989-90. On the basis of an increase in spending of 7½% above local authorities' budgets for 1988-89, this amount of grant would be sufficient to keep rate increases in Wales broadly in line with those for the non rate-capped authorities in England. (No Welsh authorities are rate-capped.) However we argued that the Welsh figures took no account of likely use of special funds and made no allowance for buoyancy in their

CONFIDENTIAL

rate basis. Once those adjustments were made, a rather lower quantum of grant would be consistent with rate increases broadly in line with those projected for the non rate-capped authorities in England.

4. We suggested a figure of £1311 million for AEG in Wales. This was on the basis of the same percentage (4.6%) uplift in 1988-89 AEG for Wales as in England. We had to acknowledge that this would not be enough to suggest rate increases in Wales would be in line with those forecast for England. But we did not accept such an objective for Wales: rate bills are very much lower in Wales than they are in England at present. Moreover rate increases were not the only criterion to be considered: in particular the danger of encouraging a surge in expenditure if too much grant were provided, carried greater weight in the view of Treasury officials.

5. I understand that Welsh Office officials somehow contacted Mr Walker after the morning session, despite the fact that he is in Russia. He agreed that they should settle at £1325-£1330 million. After further discussions in the afternoon, and consistent with the negotiating brief you gave us yesterday, I suggested that a further £5 million might be available in recognition of the low rateable value base in Wales (on the understanding that this was a proposal subject to your approval). I did however venture to indicate that refusal to settle at £1316 million overnight would be likely to make us revert to £1311 million; and that Welsh Office Ministers would then have to take their case before E(LA) tomorrow and very likely to full Cabinet on Thursday. Welsh Office officials then reluctantly agreed to recommend a settlement of £1316 million to their Ministers this evening.

Conclusion

6. I recommend that you accept a fixed grant settlement of £1316 million for 1989-90 in Wales. Even at this level, unless Welsh Office officials assume a heavy drawdown of special funds - and Welsh Office budgets for this year show no drawdown

CONFIDENTIAL

of special funds - they will find it difficult to present such a settlement as allowing rate increases in Wales for 1989-90 to move broadly in line with those projected in England. There is no real danger that such a settlement can be presented as being much more generous than in England. It is certainly a little higher in terms of the overall percentage increase in AEG but the Welsh will for example face extra costs in preparing for the Community Charge, eg bilingualism and a much higher proportion of Community Charge rebates. Nor do I think that such a settlement would create any damaging precedent for the negotiations with Scotland still to come.

7. Welsh Office officials are to brief Mr Wyn Roberts tomorrow: I understand he is attending the E(LA) discussion and is unfamiliar with the subject. If you wish to go for a tougher deal than £1316 million, it would be desirable to arrange a meeting some time tomorrow with Mr Roberts. Alternatively if you are content I suggest your Private Office might telephone Mr Roberts' Office tomorrow.

8. Subject to your view, we will need to consider early tomorrow how the Welsh settlement is best handled in E(LA). Depending upon your decision we will also provide briefing during the course of tomorrow on the Welsh settlement.

Barry H. Potter

BARRY H POTTER

Separate note submitted
on Welsh settlement. Briefing
on Wales will be provided
tomorrow. BHP 5/7

FROM: R FELLGETT
DATE: 5 JULY 1988

1. MR POTTER
2. CHIEF SECRETARY

cc PS/Chancellor ←
Sir P Middleton
Mr Anson
Mr Phillips
Mr Edwards
Mr Turnbull
Miss Peirson
Mrs Case
Mr Call

1989-90 RSG SETTLEMENT

This submission provides briefing for the meeting of E(LA) at 6.00pm tomorrow (6 July), which will need to settle all necessary outstanding issues ahead of the announcement of the RSG Settlements for England and Wales and closedown in both countries.

2. On closedown, you will wish to support the proposition in Mr Ridley's paper that the present RSG systems should closedown forthwith in both countries. The arguments are all in the paper at appendix A to Mr Ridley's paper, and are unlikely to be rehearsed much. Colleagues seem unlikely to object to this proposal.

3. You will, however, wish to insist (and have recorded in the minutes as necessary) that agreement to closedown is on the understanding that:-

- Wales should closedown with England to avoid invidious comparisons between similar counties each side of the border in countries with similar grant systems;
- DOE provide satisfactory assurances that the legislation will be watertight, and safe from judicial review substantially undermining its policy purpose, as the Prime Minister earlier requested;

- it is absolutely clear that the necessary, and admittedly controversial, Bill will be taken through the Commons without any financial concessions.

4. Colleagues are unlikely to complain about the level of Aggregate Exchequer Grant that you have agreed with Mr Ridley should be paid in 1989-90. They may feel bounced, but they will have no overriding reason to object on service grounds and cannot reasonably complain about projected rates rises of 5% on average, less than in 1988-89. If necessary, you can explain that:

- you have very reluctantly moved from your earlier position of an increase of £520 million to an increase of £600 million, and agreed to forego a potential underclaim estimated by DOE at £350 million in recognition of the fact that some repayment of underclaim would normally be expected for each of the three years 1987-88, 1988-89 and 1989-90; and to avoid specious grant payments generated by creative accounting;

- the grant actually to be paid in 1989-90 is therefore around £1.1 billion more than in 1988-89, a substantial increase of around 8% which will even on DOE's projections produce modest rate rises of just 5% (compared to average rate rises of over 7 percent in 1988-89).

5. You will wish to insist (and have minuted) that this is your last word on grant, and that it takes full account of the repayments that might otherwise be made in respect of earlier years.

6. E(LA) should agree without difficulty that the capital consultation paper should issue, also on 7 July.

7. Mr Ridley is now simply proposing that there should be an unallocated margin, without seeking agreement to its size. You can accept this, but refuse to settle on any figure for the size of margin. You can agree in principle with Mr Ridley's argument

that a margin is needed to signal that the aggregate of GRE (the Government's view of what local authorities need to spend) is not as great as its view of what they are likely to spend (ie broadly provision). The size of margin and hence the aggregate level of GRE within the agreed level of provision will then be decided later; at that point, higher GRE (which service colleagues will favour strongly) might usefully be traded-off against other objectives.

8. The proposals on rate capping should also be agreed without dissent.

9. The major debate is therefore likely to be on expenditure provision. Your intention is to argue for something less than Option 2, perhaps Option 3, with the aim of allowing Mr Parkinson to sum up in favour of Option 2, which is Mr Ridley's position. A note of the main points to make is attached.

10. Service colleagues are, however, likely to argue strongly for provision higher than option 2. Although it is 8% more than provision in 1988-89, public comparisons will inevitably be made with local authorities own budgets and option 2 therefore treated as broadly a real terms freeze (plus community charge costs). An increase in police expenditure of perhaps 10% is unavoidable (8% for pay and 2% for manpower increases already agreed), as may be a teachers pay settlement of at least 5% and probably volume growth in personal social services of at least 1% to allow for the aging population and post Cleveland efforts. Together, these three areas amount to almost half of local authority spending. Within option 2 provision, the remaining areas will therefore face an increase of only 2%, or a real terms cut of 2%. Service colleagues are likely to be aware of this very broad arithmetic, and to be accordingly firm in their arguments for something over Option 2 provision.

11. Indeed, we need to be cautious about settling provision so low that a subsequent decision, say on the teachers pay settlement, could only be handled by increasing the total of

CONFIDENTIAL

provision. That would be liable to reopen the grant total as well. There would therefore be something to be said from your viewpoint also for compromising between options 2 and 1, but that has to be set against the wider Survey considerations.

12. Finally, you asked how Option 2 provision had changed from £29.1 billion to £29 billion. I gather that £50 million of the reduction reflects a lower budget return by Camden to DOE, and £40 million is a result of correcting a misunderstanding between DOE and Home Office officials about the interpretation of police expenditure figures in a number of authorities budget returns. The remaining £10 million is the net result of a number of minor adjustments, mainly to take into account later information.

Robin Fellgett

R FELLGETT

Arguments for provision below option 2

(Option 2 is £29 billion; up 8% compared to provision in 1988-89; up 4% plus £110 million Community Charge costs compared to local authorities own 1988-89 budgets; a claim of £1.2 billion on the Reserve).

1. Cannot provide as much as £1.2 billion from Reserve (of £7 billion). Would compromise the rest of the Survey, where colleagues have put in very substantial bids for their central government programmes.

2. Must not increase provision by 8% compared to provision we agreed for 1988-89. That would be twice the rate of inflation. Utterly the wrong signal to give to local authorities, and might be seen in financial markets and elsewhere as the government losing its grip.

3. The level of provision (and implied claim on the Reserve) matters crucially in the presentation of the RSG Settlement now. By the Autumn, when colleagues will need to defend the service allocation to their programmes, we will (if colleagues agree) have announced a new planning total which will no longer include local authority expenditure.

4. [For use if Mr Ridley mentions this argument - DOE are being reticent about it, and points about the distribution of grant are primarily for the Environment Secretary]..Believe that the 'resource equalisation system' in the present RSG system means that, at a fixed level of grant, higher provision actually diverts grant away from high resource south eastern areas towards low rateable value authorities in the north and west.

Defensive

5. Service provision needs to be fully realistic and take account of individual bids for extra policemen, teachers pay etc etc.

- We have always defended service provision a little less than local authorities might in the event spend and this will be easier than ever once the new planning total is announced;
- Will discuss individual service bids later, and take full account of expenditure increases to which the government is committed in deciding on the service allocation of overall provision in the Autumn.

Need to push up provision to enable GRE's to be pushed up also:

- Aggregate of GRE's an issue to be settled in deciding on the size of unallocated margin that would be right with any agreed level of provision. Note that Environment Secretary's earlier proposal already involves 8% increase in aggregate level of GRE.

Government committed to higher LA spending (appendix D to Mr Ridley's paper):

- Note that £800 m commitment mentioned at last E(LA) now costed as £690 m; can be accumulated within provision options; just two and a half percent out of 7% increase in provision under Option 3 or 8% increase in provision under Option 2.