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don't want to  
I am for too  
to do a general  
to myself. This is  
to contact in  
to Thomas  
28 ii*

FROM: A P HUDSON  
DATE: 28 FEBRUARY 1989

- 1. MR EDWARDS
- 2. CHIEF SECRETARY

*Agreed with me  
AJCE  
cc  
Chancellor  
Sir P Middleton  
Mr Anson  
Mr Phillips  
Mr Monck  
Mrs Case  
Mrs Lomax  
Miss Peirson  
Mr MacAuslan  
Mr Potter  
Mr Mortimer  
Mr G C White  
Mr Brook  
Mrs Chaplin  
Mr Call*

*Q  
I don't feel very strongly about the  
choice between the two options discussed  
in this note. My instincts are to  
stick with the present system & refuse  
to reopen AEF, but that's probably just  
because that's how I would  
do it.*

TREATMENT OF LOCAL AUTHORITY CURRENT EXPENDITURE IN THE 1989 SURVEY

We now have all the responses to your 31 January letter to colleagues proposing arrangements for the handling of local authority current expenditure in the 1989 Survey.

The Main thrust of the responses

- 2. Ministers have agreed to most of the key proposals:
  - a July announcement of an envelope of "Aggregate Exchequer Finance" (AEF) covering the NNDR, revenue support grant, and certain specific grants, without breaking this envelope down into its components;
  - the July announcement to include the aggregate need to spend, and the community charge for spending at need (CCSN);
  - Survey baselines for specific grants, and for RSG plus NNDR taken together, to be derived by uprating the corresponding 1989-90 figures by 2½ per cent for each of years 1 and 2, with the same uplift for year 3 as elsewhere in the Survey. It is pleasing - and somewhat surprising - that colleagues did not object to this approach. Although it is a concession from our original proposals, it nonetheless forces them to bid uphill.

3. You suggested that these issues should be discussed in E(LA). I understand, however, that the Prime Minister has decided they should be discussed in E(LF) under her chairmanship.

4. Most of the points made in the responses to your letter are really markers for the Survey discussions, and for next year's arrangements.

- There is general agreement that the arrangements should be reviewed before the 1990 Survey, with some strong support for a move to an October announcement in future (Messrs Clarke, Baker, Channon, and Hurd).
- Messrs Baker, Channon, and Hurd stress the importance of a realistic figure for the needs assessment, taking account of service needs separately. This is consistent with their enthusiasm for a "bottom up" approach to determining aggregate needs, against which we will need to set considerations of affordability and overall public expenditure constraints - you registered this point in your 14 February letter to Mr Ridley about the arrangements for consultation with local authority associations.
- Mr Hurd accepts your baseline proposals for specific grants as a benchmark. But he points out that they do not even match the increases agreed in last year's Survey. He says he would not wish to see his bids judged "against a benchmark which is clearly unrealistic". HE advise that there will be a bid for around an extra £100 million to cover the Edmund Davies pay formula, which will be virtually irresistible.

We do not think it is worth picking up any of these points at this stage. We shall take them into account in considering the strategy for the Survey, which you may want to discuss with us in the Spring.

## The nature of the July Envelope

5. The serious issue emerging from the responses is how far colleagues are prepared to regard the July envelope as fixed.

6. Mr Baker suggests in his letter that the AEF envelope should be regarded as flexible after it has been announced in July. Mr Ridley and Mr Walker both say that they will expect to be consulted if decisions on specific grants in the autumn have implications for the level of RSG.

7. Their concern is this. In July, a decision will be reached on the total of AEF, based on assumptions, which will not be announced, about the likely breakdown between specific grants, NNDR, and RSG. Mr Ridley will want to secure agreement not merely on an adequate level of AEF, but, within that, on a reasonable level of RSG - this is the grant which is specifically his responsibility. Within a fixed AEF envelope, however, any increase in specific grants agreed in the Autumn will be offset in full by lower RSG. Mr Ridley's concern is that, to take the most likely example, a significant increase in the police grant might leave him with a level of RSG which he would regard as unacceptable. That is why he asks to be consulted. Mr Walker is in the same position.

8. Behind Mr Ridley's request to be consulted is the danger that he would ask for an increase in the AEF envelope which had been agreed and announced in July, so that the increases in specific grants did not result in lower RSG.

9. Re-opening the AEF decision would be an extremely bad outcome from the Treasury's point of view.

- One of the arguments for settling AEF early is that it gets that aspect of the Survey out of the way.

- When we discussed this last month, you thought that a generous local authority settlement was probably unavoidable and proposed to use this as a constraint on the rest of the Survey. The last thing we want is to have a generous settlement reopened.
- The final announcement of AEF will come in late October, shortly before the Autumn Statement. It would be an extremely bad start - not least for market management - if the Government had to announce that it had failed to stay within a total set only three months previously.
- Arguably, it would also be bad politics. The local authorities are bound to say that the July settlement is inadequate, and there will be some dire predictions about the level of community charges. Extra finance in October would look as though the Government was trying to buy off these consequences.

10. To put this in perspective, the amounts involved should not be very large. The papers for the July E(LF) discussions would have to include realistic forecasts of the level of specific grants. The risk for Mr Ridley would thus be the difference between the total of specific grants that emerged from the bilaterals, and the figure assumed in July. It should be possible to estimate the large police grant to within a maximum of £30 million, and probably less. So even if there were increases in some of the smaller grants, the amount at stake would not be very great, in the context of an AEF envelope of perhaps £23 billion.

11. We understand, however, that Mr Ridley would try to reopen AEF for sums of this size, and that Mr Walker would do the same for as little as £5 million. They would argue that the increase in specific grants meant that the Government itself was putting upward pressure on the Community Charge, which would be compounded by reducing RSG. It would be difficult to deny this: experience suggests that higher specific grants lead mainly to higher spending, whereas an increase in RSG is mainly reflected in lower rates. We shall be using precisely this argument ourselves to resist bids for higher specific grants.

12. Mr Ridley would also argue that higher specific grants should mean an increase in the aggregate need to spend, and hence in the Community Charge for spending at need (CCSN), both of which would be published in July. We would try to resist this on the grounds that the aggregate need to spend was a measure of affordable spending. But the terminology is against us: we might not get much support for the argument that, because spending on the police had increased, other spending which had been 'needed' in July was no longer 'needed'.

13. The question is whether you could hold the line on refusing to reopen AEF. Although the sums involved are relatively small, Mr Ridley would try to run the argument that they could therefore be readily conceded, to avoid any upward pressure on community charges at all. None or the other members of E(LF) would have any reason to side with the Treasury, and the Prime Minister will no doubt be very concerned about the implications for the community charge. So there must be some risk of not being able to hold the line.

**A possible alternative approach: decide specific grants in July**

14. To reduce the risk of AEF being reopened you might like to consider handling the discussions in a slightly different way. Instead of the original approach of making a forecast of specific grants in July, with discussion to follow in the Survey bilaterals, we could aim to reach agreed decisions on these grants in July, as far as we possibly could. In practical terms, it should be perfectly possible to settle most, if not all of them.

15. Compared to the original intention, this approach has both pros and cons, from the Treasury's point of view.

16. The pros are:

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- (a) it would minimise the chance of AEF being reopened;
- (b) it avoids the awkwardness of having to make a realistic forecast of specific grants in July, which might become a floor for negotiations in bilaterals;
- (c) it provides an opportunity, which has never existed before, for collective discussion of the settlement of specific grants. Within any given total for AEF, higher specific grants would lead to higher local authority spending, higher community charges, and higher GGE. You might be able to agree with Mr Ridley the broad outcome for AEF and RSG, and make common cause to beat down bids for higher specific grants.

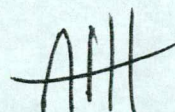
17. The cons are:

- (a) you might have a better chance of making spending Ministers think more critically about specific grants if they were discussed in the autumn bilaterals;
- (b) in the case of the police specific grant, HE division would have more time to exploit the results of the current inter-departmental study on police output and performance indicators in discussions on forecast police manpower needs;
- (c) there is a risk that E(LF) might be in favour of high bids on both specific grants and RSG, with a very high figure for AEF as a result;
- (d) there would be a certain amount of extra work for you in June and July, though only the Home Office grants might require an extra meeting.

## Assessment and Next Steps

18. We think the choice between these two approaches is finely balanced. The approach we originally envisaged gives us more options on specific grants, but carries the risk of AEF being reopened. The alternative reduces this possibility, but carries some risk that higher bids on both fronts will be accepted. The issue comes down to which approach gives you the best negotiating position, and whether you think AEF could be made to stick if specific grants were increased in the bilaterals.

19. In terms of writing to colleagues, we think the first thing to register is that AEF must remain fixed. We think it is then, on balance, worth putting forward the alternative way of handling specific grants, and I attach a draft letter on that basis. If you prefer to stand pat on the original approach, I shall let you have a revised letter. In either case, it would be very helpful if you could write within the next day or so, so that the approach can be agreed before the Survey guidelines are circulated on 15 March.



A P HUDSON

**DRAFT LETTER FROM CHIEF SECRETARY**

The Rt Hon Nicholas Ridley AMICE MP  
Secretary of State for the Environment  
2 Marsham Street  
LONDON  
SW1P 3EB

March 1989

**TREATMENT OF LOCAL AUTHORITY CURRENT EXPENDITURE IN 1989 SURVEY**

Thank you for your 7 February letter in response to mine of 31 January, which proposed arrangements for the handling of local authority current expenditure in the 1989 Survey. I am also grateful to other colleagues for their comments.

I am grateful to you and colleagues for your general agreement to my proposals. I note the points made about baselines and the importance of the decision on the aggregate need to spend. These are things we shall clearly want to consider very carefully during the Survey.

The most significant point which has arisen in the correspondence ~~is~~<sup>is</sup> Kenneth Baker's suggestion that there may be a need to change the funding envelope in October from the figure announced in July. I have to say that I cannot agree with this. If we are to announce the envelope in July, we must stick to it. Setting one envelope in July and then another three months later is no way to conduct business, and would be thoroughly out of character. It would mean a very bad start to the main public expenditure announcements.



If you and colleagues are concerned that decisions in October on specific grants could exceed expectations and thus lead to changes in RSG within the fixed envelope, I suggest we should aim to decide specific grants, as far as possible, in July. So far as I am aware, there is nothing to prevent this, except possibly in the case of police grant; but even there, the outcome should be clear to within £20-30 million. This is a tiny amount in the context of a funding envelope which is likely to be over £20 billion, and thus would remove any question of reopening the July decision.

I am copying this to the Prime Minister, to members of E(LF) and E(LA), and to Sir Robin Butler.

JOHN MAJOR



FROM: A C S ALLAN  
DATE: 1 March 1989

*ps*

PS/CHIEF SECRETARY

cc Sir P Middleton  
Mr Anson  
Mr Phillips  
Mr Monck  
Mrs Case  
Mr A J C Edwards  
Mrs Lomax  
Miss Peirson  
Mr MacAuslan  
Mr Potter  
Mr Mortimer  
Mr Hudson  
Mr G C White  
Mr Brook  
Mrs Chaplin  
Mr Call

TREATMENT OF LOCAL AUTHORITY CURRENT EXPENDITURE IN THE 1989 SURVEY

The Chancellor has seen Mr Hudson's minute to you of 28 February. He trusts the Chief Secretary does not believe the argument that "an increase in RSG is mainly reflected in lower rates". The Chancellor's experiences over many years make him too cynical to believe it himself. And in any event to concede it would be to throw away one of the Treasury's main arguments for a tough RSG: viz the need to control spending.

*ACSA*

A C S ALLAN