CONFIDENTIAL

1. MR ~~PHILLIPS~~

2. CHIEF SECRETARY

Ch
Longwinded but sensible. CST needs to be v tough. (No need to read Annexes)
AA

FROM: B H POTTER (LG1)
x4790
Date: 27 April 1989

Copies attached for:

Chancellor
Paymaster General

cc: Sir Peter Middleton
Mr Anson
Mr Monck
Mrs Case
Mrs Lomax
Mr Edwards
Miss Peirson
Mr MacAuslan (GE)
Mr Hudson (LG)
Mr G White (LG)
Mr Rutnam (LG)
Mr Call
Mrs Chaplin

I have discussed this in draft with LG & GE. You are already well aware of the special difficulties for this 1st year for the C.C and NPT. I should underline that the expenditure numbers in these pps are very tentative.
WP.
27/4

Yes. Noted. [illegible] 2. CST [illegible]

LOCAL AUTHORITY CURRENT: TREASURY STRATEGY FOR E(LF)

This note and attached papers recommend a strategy for Treasury Ministers to pursue in the E(LF) negotiations on the 1990-91 local authority (LA) current settlement in England+. The papers are the work of Messrs Hudson, White and Rutnam in LG1. The note and papers have been discussed with Mr Phillips, Mr Edwards and GE.

2. This year's negotiations will be the first under the new community charge regime and the new planning total. The structure of the negotiations was set out in your letter of 31 January and the timetable is summarised at Annex A. This note is concerned with the main steps between now and end-July. In that interval E(LF) must determine and announce for England for 1990-91:

- Aggregate Exchequer Finance (AEF);

- the assessed need to spend; and

- the community charge for spending at need (CCSN).

+The arrangements for Scotland and Wales will be dealt with separately.

POTTER
→ CST
27/4

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(A diagram showing the relationship between these variables, their component parts and actual community charges and actual LA current spending is at Annex B.)

3. It is AEF which scores directly in the new planning total; both assessed need to spend and the CCSN are in the nature of supporting information to the E(LF) decision on AEF.

Objective

to DoE not necessarily to Tsy

4. Clearly the potential/actual or "doorstep" community charges will be of greatest concern. But much attention will also be paid to the CCSN at E(LF) given the need to announce a politically saleable figure in July. There will be enormous pressure for a big increase in grant for local authorities in order to engineer low community charges.

5. However the overall aim of the community charge policy needs to be emphasised: it is to control and restrain local authority spending more effectively than in the past through greater accountability to the electorate - not to provide extra grant that will generate higher LA spending. For 10 years, the Government has been trying to rein back LA spending by cutting the grant percentage and (until this year) discouraging extra spending at the margin. Continuity of that policy is critical now, particularly in the absence of any financial pressures at the margin.

6. In place of such financial pressures is the improved electoral accountability of the new local government financial regime. But in 1990-91 at least that accountability cannot be expected to hold back LA spending; because:

   i) local councils will feel able to budget high and blame central government for whatever the consequences are in terms of high Community Charges (CCs);

ii) the operation of the safety net (see separate section) will blur the impact of LAs budgets decisions on the CC;

iii) the transition from a local tax system based on the tax liability flowing from property to one based on individuals liability will (even after the safety net) make it difficult for electors to judge the LA's spending performance;

iv) the only elections in 1990 will be in London (plus a minority of shires and metropolitan districts).

7. Given the need for continuity of policy on LA spending and the very weak pressures on spending at the margin, the Government's and Treasury's traditional objectives on LA current spending must remain in place for the negotiations. Despite the special circumstances, your main aim should be to hold down the quantum of Exchequer support (AEF) towards local authority spending. AEF scores directly in the NPT and is the instrument designed to deliver the Treasury's underlying objectives:

a) bringing downward pressure to bear on local authority spending, all of which scores in GGE (the ultimate target of the Government's public expenditure strategy); and

b) minimising the burden of local government spending on the general taxpayer.

8. This leads to a potentially useful argument in the E(LF) negotiations for Treasury Ministers. For 10 years the degree of Exchequer support for LA spending has been perennially and consistently declining: it would be wrong and indeed contrary to the whole thrust of the new local government finance regime to reverse that policy now. The most that Treasury Ministers might support would be a temporary suspension of the downward pressure ie to maintain, rather than continuing to cut, the grant percentage (newly defined as the ratio of AEF: need to spend) in 1990-91.

Negotiation Framework

9. However the negotiating mechanisms for achieving your aims must change this year. The focus of the negotiations must be shifted to reflect the new local government finance regime.

10. As you will recall, in past years the two key decisions in E(LA) have been on provision for total (relevant) current expenditure and the quantum of Exchequer support (the old Aggregate Exchequer Grant (AEG)). These decisions were taken against a back-drop of forecast levels of total (relevant) current expenditure, actual levels of Aggregate Exchequer Grant and the projected consequences for rates. Though the provision for total current expenditure in the PEWP did not fully reflect the central projection of LA current spending, the decisions were very much based on forecast levels of actual local authority current expenditure and rates.

11. The negotiations under the new regime should focus on Exchequer support as before. But the back-drop of supporting information announced in July will not be on forecast levels of actual spending and local taxes but on the assessed need to spend, and the community charge for spending at need (CCSN). Under the new regime, it is these variables which central government determines: actual spending and actual community charges are for the local authorities to decide. This is of course reflected in the new planning total presentation.

12. A new form of negotiation framework is required. The choice lies between two approaches: the first - A - would assess the CCSN directly; the second - B - would first establish actual CCs and work back to the CCSN.

A			B		
	Need to spend			Actual spending	
AEF	CCSN	CCSN	AEF	"doorstep" CCs	.
	.	.		.	.
	.	.		.	.
	.	.		.	.
	.	.		.	.

13. There are a number of powerful Treasury reasons for adopting approach A:

- it follows from the logic of the new financial regime and the NPT;

- it is the CCSN which can be determined; projections of "doorstep" CCs are subject to a wide margin of error (like DOE's old projections of domestic rate increases);

- it is more likely to deliver Treasury objectives: under approach B, E(LF) will be frightened by the prospect of large CC figures and driven further down the table towards higher AEF figures; taking approach B and working back to acceptable figures for CCSN and need to spend would be to our tactical disadvantage;

- approach B takes the decisions in the wrong logical sequence ie it decides actual spending before need to spend; moreover how much actual spending is to be reflected in the LA self-financed expenditure in the Autumn Statement is a decision for the Treasury (in consultation with DOE) not E(LF) to take.

14. However, it is by no means clear that other Ministers including the Prime Minister, will be easily convinced that an approach along the lines of A above is best (although DOE will probably support it). Most members of E(LF) will have a very natural inclination to favour negotiations around actual forecast spending and actual community charges, not the CCSN. In particular, there will be a strong desire to inject more grant into local authorities in order to hold down actual community charges. For the reasons set out above, that would be to our tactical disadvantage. But the case for approach A is best set out in any discussion (including the opening meeting with the Prime Minister referred to in paragraph 41) as follows:

- the Government is responsible for the CCSN, not for individual CCs - they are up to the individual authority; that is part of the political attraction of the new regime;

- some authorities will set high CCs for political reasons, whatever the Government does; giving more grant to such authorities does not change their CC plans, it only increases their expenditure; high community charges reflect overspending;

- the vast bulk of local authorities have other sources of income than the CC to meet actual expenditure: they could set higher than assumed fees or charges, make use of trading profits or turn to the significant balances and reserves available; (partly as a result of closedown of the old regime huge amounts are sitting around on deposit); such sources of income could amount to around 20% of total CC income;

- in short, one level of AEF is consistent with quite a range of outcomes on actual CCs - the choice is up to individual LAs; (this year we hope to have our own computer model of the local government finance system so that we are not at the mercy of dubious DOE projections);

- as a last resort, the Government has a power to cap community charges - if some authorities are taking political advantage to raise charges to an unacceptable level in order to embarrass the Government; in the short-term at least, before accountability can be made to work, capping may have a useful role to play in holding down actual CCs.

Safety net

15. The position on community charges (both the CCSN and actual) is much complicated, however, by the safety net. You will recall that in broad terms, the safety net will ensure that the burden on local taxpayers in 1990-91 (paid in the form of community charges) in any LA will be the same in real terms as the local tax burden in 1989-90 (paid in the form of domestic rates), assuming that the LA's spending also stays constant in real terms. In practice, this will be achieved through the distribution of Revenue Support Grant. It was also agreed by E(LF) that the safety net should be self-financing ie no Exchequer contribution, so that gaining areas (relative to the no safety net position) compensated the losers.

16. Within Revenue Support Grant* the needs element would normally be distributed in proportion to each authority's GRE. But the safety net effectively <u>overrides</u> the GRE system and distributes revenue support grant so as to achieve the transitional objective described above. In practical terms, this means that in 1990-91 the CCSN is only a theoretical long-term CC for LAs; in reality, if an LA spends at need (ie = GRE), the CC would be the CCSN + safety net adjustment. (Some examples are shown in annex D.) These CCSN + safety net figures will be identified for each authority on the Community Charge Demand Note sent to each household. So like the CCSN itself, they are a central government responsibility.

17. The importance of this is that we can readily envisage E(LF) taking a two-stage approach to the negotiations. The first part would be as in approach A - to determine the CCSN. But the second part would be to exemplify the CCSN + safety net figures for each authority or group of authorities. This will highlight two problems: the high starting CC in inner London (which will rise further in subsequent years) and the high starting CCs in the

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*RSG payment to an individual authority comprises a needs element paid in proportion to its assessed need to spend (=GRE) and a small standard element paid as a lump sum per adult.

South-East (which will then fall). Some preliminary soundings within DOE indicate that they wish to look at changes in the safety net arrangements in order to improve the starting distribution of CCs. Anything more than tinkering would require an injection of Exchequer funds, ie more Revenue Support Grant which, under some transitional arrangement, would be directed at reducing the CCSN + safety net figure in selected areas.

Dangerous

Strategy

18. Against that background, our recommended strategy is therefore that you aim to concentrate the discussion on AEF, need to spend and the CCSN; and that your specific objectives should be:

(i) the minimum achievable amount of AEF.

(ii) the minimum achievable assessed need to spend;

[(iii) the maximum politically defensible CCSN;]

not a Tsy objective per se; follows from (i) & (ii)

(This combination reflects the simple equation: AEF = assessed need to spend - (CCSN x population).+)

On the safety net, our proposed strategy is to avoid changes to the existing agreed safety net, unless they can be contained within a satisfactory outcome on AEF (ie objective (i)).

+In full the equations are:

i) AEF = assessed need to spend (net of interest income, fees and charges) - (CCSN x population)

ii) AEF = actual revenue spending - relevant grants not in AEF - transfers from balances - (actual CCSN x population).

19. The main area of difficulty is all too clear. Both the objectives and the weights attached to the variables will be different for other members of E(LF). We expect all Departments (and the Prime Minister) will argue for a low target CCSN; and a high assessed need to spend. Several Ministers will see AEF, even though it is crucial for public expenditure, as the residual.

20. Although the balance is very hard to predict, it may be the Prime Minister, the "neutrals" on E(LF) and to some extent Mr Ridley who argue most strongly for a low CCSN. Other Departments particularly Education, Home Office, Health and Transport will of course support that. But they may concentrate their fire on getting the assessed need to spend up: their officials see the introduction of the CC as an opportunity for a one-off upward shift in needs (paid for by more Exchequer support).

21. You will wish to argue that AEF and need to spend are critical. (But it does not seem wise for you to argue that through to its logical consequence ie that the CCSN should be a residual.) In short a main tactic in the negotiations must be to avoid AEF becoming a residual and instead seek to persuade colleagues of its important wider implications for actual LA spending and hence GGE. Moreover if the balance on the committee is as indicated above, you should be able to find more support for keeping down AEF by focusing on restraining need to spend, than arguing up the CCSN.

22. It is helpful to look at each of these variables separately. The arguments are summarised below and set out more fully in the attached papers.

Detailed Strategy

23. Before setting out the detailed approach in terms of possible bid and your target and fallback position I should point out that all numbers are highly preliminary and not agreed with DOE officials.

24. First on AEF, you will face the conventional alignment of forces. The Treasury believes that higher exchequer support for local authorities leads to higher spending; DOE and Departments stick to the view that higher grant enables lower local taxpayer contributions. This will clearly be an important theme for the Treasury in the discussions. And LG take the view that the evidence of recent years tends to support our case (see paper A):

- local authority current expenditure has been growing in real terms since 1986-87;

- over the last few years, this growth has exceeded the growth rate in GGE; local authority current expenditure is contributing to the problems of the Government achieving it's overall objectives in terms of the GGE/GDP ratio; in earlier years LA current spending was part of the solution;

- the resumption of real growth in LA current spending in the mid 1980s coincided with the end of the strong downward trend in Exchequer support as a proportion of total local authority current expenditure ("the grant percentage") (see paper A);

- since the mid 1980s, the marginal disincentive to spend has been progressively reduced (in terms of different regimes): in 1989-90 such disincentives were abandoned altogether - and local authority spending bounded upwards by 4½% in real terms;

- from 1990-91 onwards there will again be no financial pressures at the margin, and as noted accountability cannot have any effect in that year; as recognised last year in E(LA) the absence of financial pressures at the margin requires a lower quantum of Exchequer support in order to restrain LA spending.

It will be important to focus this argument on the consequences of AEF for spending. DOE and others will see AEF in terms of reducing the CCSN: the arguments against that approach were set out earlier.

25. In the narrower context of AEF as a percentage of assessed need to spend, there are other useful points to make:

- there is no case for greater support to LAs as the CC is introduced: this belies the purpose of the new regime - the long term approach should be less taxpayer support and more local authority accountability:

- the political dangers of putting in excessive grant - "bailing out the poll tax"

- the wider pressures on the NPT means more AEF would limit the room for manoeuvre elsewhere in the Survey.

26. As yet, there is no indication of the likely bid from spending Departments/DOE. Our starting assumption is that they will look for AEF of around £24.1b - sufficient to finance an assessed need to spend which will maintain in real terms last year's budgets combined with a CCSN no higher in real terms than in 1989-90. That would represent a bid of +£2.5b on the 1989-90 figure equivalent to +£1.9b on the 1990-91 baseline.

ghastly numbers

27. Our provisional assessment is that a target objective on AEF for England in 1990-91 should be £22.6b, an increase of £400m on baseline and of £1.0b on the corresponding equivalent aggregate for 1989-90. This would maintain AEF in real terms.

28. It is worth noting that within this AEF figure, RSG would then be cut in real terms. In part, this is because there is likely to be a real increase in police specific grant within AEF. But the main reason is that NNDR income is likely to be more buoyant (because the NNDR poundage is to be uprated by the 1989 September RPI inflation) than AEF as a whole (uprated by the 1990-91 GDP deflator). There is no forecast of the September 1989

6·3% in last profile

RPI available to LG at this stage: but if we assume buoyancy of 1% and an September-September RPI change of 6½%, then NNDR income would rise by 7½%. AEF would rise by 4% if uprated by the present forecast GDP deflator for 1990-91 though that figure might privately have to be acknowledged as a little too low in the E(LF) discussions). (It will of course be important to resist any suggestion from Mr Ridley that the uprating on the NNDR poundage should be less than suggested by the September-September RPI.)

29. The fallback objective would be an AEF of £23.1b, an increase of +£900M on baseline and £1.5b on 1989-90. This would amount to a very small addition to grant (RSG and the relevant specific grants) in real terms (around 1½%). It would also allow local authorities to retain the benefit of the real buoyancy in NNDR income.

30. Second, on assessed need to spend, there are very real demographic (more old people etc), policy (community charge collection costs, abolition of ILEA) and relative price effect (police, fire and LA manuals wage increases) upward pressures on the need to spend in 1990-91. These are described in full in Paper A.

Mustn't accommodate

31. Departments will press strongly for a step upward in needs. But there are good counter-arguments for holding back (set out more fully in paper C):

- there is no justification for a steep increase in 1990-91 in assessed need to spend; indeed last year there was a one-off upward adjustment in the figure; it has been accompanied by a substantial real increase in local authority spending;

- any such increase now would be interpreted as a signal to spend up under the new regime;

- the aggregate need to spend must be held down, so that only a very small proportion (probably less than 10%) of local authorities could reasonably be expected to budget within it: there is clear evidence from the behaviour of Scottish local authorities, when the community charge was introduced this year, that the publication of need to spend figures for each authority became minima even for previous low spenders (see separate annex C);

- the evidence of scope for further efficiency savings identified by the Audit Commission must be reflected in the assessed need to spend;

- the new powers to set fees and charges under this year's Local Government and Housing Bill will be available for 1990-91: this should lead to higher LA income (which is netted off the measured assessed need to spend);

- the new requirement to contract out more services should reduce costs and hence revenue expenditure.

32. There is an awkward gap in perception here. Departments will regard need to spend (equal by definition to aggregate GREs) as a concept close to old-style provision - what central government planned for LAs to spend. We think of it as defining best-practice, a target for LAs to aim at. Consequently, the bid from Departments - though it may be derived by a bottom-up service by service approach - is likely to be framed in terms of sustaining LAs budgets in 1989-90. Even on a zero real growth basis, this gives a figure of £33.1b.

33. Although we cannot hope to ignore wholly the 1989-90 budgets (though even a partial recognition amounts to validating past overspending), we should stick to the proper interpretation of need to spend ie GREs not actual spending and take the 1989-90 GREs as the starting point. Accordingly our view is that your target should be to confine the needs figure to a small real increase in GREs ie a number around £31.7b (giving a small cash increase on this year's budgets adjusted for functional changes).

34. The fallback would be a slightly larger cash increase on LAs 1989-90 (adjusted) budgets ie £32.1b. An attractive presentational point is that this fallback taken along with the fallback AEF proposal can be presented as broadly maintaining the grant percentage, ie the degree of Exchequer support for local government, newly defined as the ratio of AEF: assessed need to spend (the only ratio anyone will be able to work out in July). This should make the package more attractive to Mr Ridley.

35. Third, there is the issue of the community charge for spending at need. As recognised at earlier discussions, the Treasury is likely to have very little support indeed for a tough line on this. All except Treasury members of E(LF) will see a case for keeping the CCSN (and by extension actual CCs) fairly low. But there are some points which you can make for sustaining the figure at a reasonable level:

- the Government has published a figure of £240 as the CCSN for 1989-90: it should not cut that figure in real terms; it will be politically very difficult this side of the General Election to let the CCSN rise in real terms; the Government should not prejudice overall targets on the GGE/GDP ratio, cuts in income taxes etc by building in an increasing burden of higher AEF on the taxpayer for several years to come.

- as with the assessed need to spend, there is no need for a downward shift in the burden of local taxes; any such move would damage the scope for future cuts in income tax;

- the CCSN must be credible: the actual CC in Scotland this year is £281 equal to £295 in constant real terms for 1990-91: figures below £250 in England will not be believed.

36. But this is unlikely to be fruitful ground for the Treasury to contest. Our guess is that a figure which maintains the community charge for spending at need broadly at the same level in real terms as the figures already published for 1989-90 is the best achievable outcome. Accordingly the proposed target is £252 (in practice, a range would be quoted anyway of perhaps £240-£265).

37. But dropping just £2 off this (the consequences for AEF are reflected in our fallback figures) leads to a cash figure of £250 for the first year of the CC. E(LF) may well find such a figure politically very attractive and this is the basis of both the bid and fallback position.

38. Finally, there is the question of the Treasury strategy on the safety net. At this point, we can only speculate on what changes DOE might propose to the safety net arrangements and what the Exchequer cost in terms of extra RSG might be. But the obvious line initially might be as follows:

- no case for tinkering with the safety net; E(LF) agreed on its broad shape last year;

- firm agreement, endorsed by the Prime Minister, that the safety net would be self-financing - is Mr Ridley going back on that now?

- safety net in Scotland is self-financing: too late to change plans.

— nonsense!

39. That said, however, this line is far from convincing. Given the degree of public criticism of the new policy in advance of its introduction, the political appeal of feeding through more of the benefits under the policy earlier in the winning areas is all too clear. In particular, we imagine DOE will wish to pursue ideas of cutting the CCSN plus safety net in the South-East, by channelling more RSG to such areas. (We are not at all sure this can be done, without primary legislation: neither are DOE.) But E(LF) is likely to find this attractive.

40. However, if a technical means can be found the Treasury has no particular reason to resist changes to the safety net, provided the cost can be contained within a total equivalent AEF that does not increase the degree of support for local authorities. So in practice, the eventual Treasury strategy might be better pitched at seeing whether within an agreed AEF more RSG can be directed at keeping down the CC + safety net in certain areas, particularly the South-East. But we will need to consider all this further as we learn more about the DOE strategy.

Tactics

41. We understand that the Prime Minister is anxious to hold a meeting with you, Mr Ridley and Mr Parkinson just before the second Bank Holiday in May. That is intended to be a ground clearing exercise; but it could lead to a much broader understanding amongst all parties. We will need to consider the tactics of this particular meeting further when we discuss the strategy with you on 3 May.

42. More generally, it seems to us that the best approach may be to seek a co-ordinated approach with Mr Ridley. Indeed a meeting with him prior to the Prime Minister's meeting might be advantageous. No-one else on E(LF) - even I fear those without strong departmental interests - looks a likely potential ally, with the exception of the chairman of E(LA). At official level, we will need to sound out DOE to test their likely line. But the fallback package along the lines set out in paragraph 44 below might just about be acceptable to Mr Ridley - if he can be persuaded either not to change the safety net or to contain the costs within that AEF total.

43. However, you will not wish to put forward even the target package as the opening offer. You will wish to give further thought to the precise tactics: but our instinct is not to go for a tough approach - because it will not be credible. On the other hand, you will wish to aim off initially, so that the target package can emerge on the basis set out below.

Conclusion

44. Our view is that you should seek to focus discussions on the assessed need to spend, AEF and the community charge for spending at need; and our inclination is that you should resist any move to put an Exchequer contribution (ie more RSG) into the safety net, unless it can be contained within an acceptable DOE total. The objectives will be to minimise AEF by aiming for the maximum politically acceptable community charge for spending at need and the minimum assessed need to spend. Our preliminary assessments of Departmental bids targets and fallback for each of these variables as realistically achievable goals is as follows:

	Bid	Target	Fallback
CCSN	£250	£252	£250
Need to spend	£33.1b	£31.7b	£32.1b
AEF of which:	£24.1b	£22.6b	£23.1b
i) NNDR	£10.3b	£10.3b	£10.3b
ii) Grant	£13.8b	£12.3b	£12.8b

	Bid	Target	Fallback
Memo items			
AEF			
on 1989-90	+£2.5b	+£1.0b	+£1.5b
on 1990-91 baseline	+£1.9b	+£400m	+£900m
Grant			
on 1989-90	+£1.8b	+£300m	+£800m
on 1990-91 baseline	+ £1.5b	-	+£500m

45. You may like to discuss the following issues with us on 3 May:

			Paragraphs
i)	the overall Treasury objectives;		4-8 & 18-22
ii)	the proposed negotiation framework;		9-17
iii)	the specific objectives on	- AEF	24-29
		- Need to spend	31-39
		- the CCSN	35-37
		- the safety net	38-40
iv)	the tactics for handling E(LF)		41-43

(You may also wish to resume the discussion on the shape of the settlement for years 2 and 3 - my submission of 28 February refers.)

Barry H. Potter

BARRY H POTTER

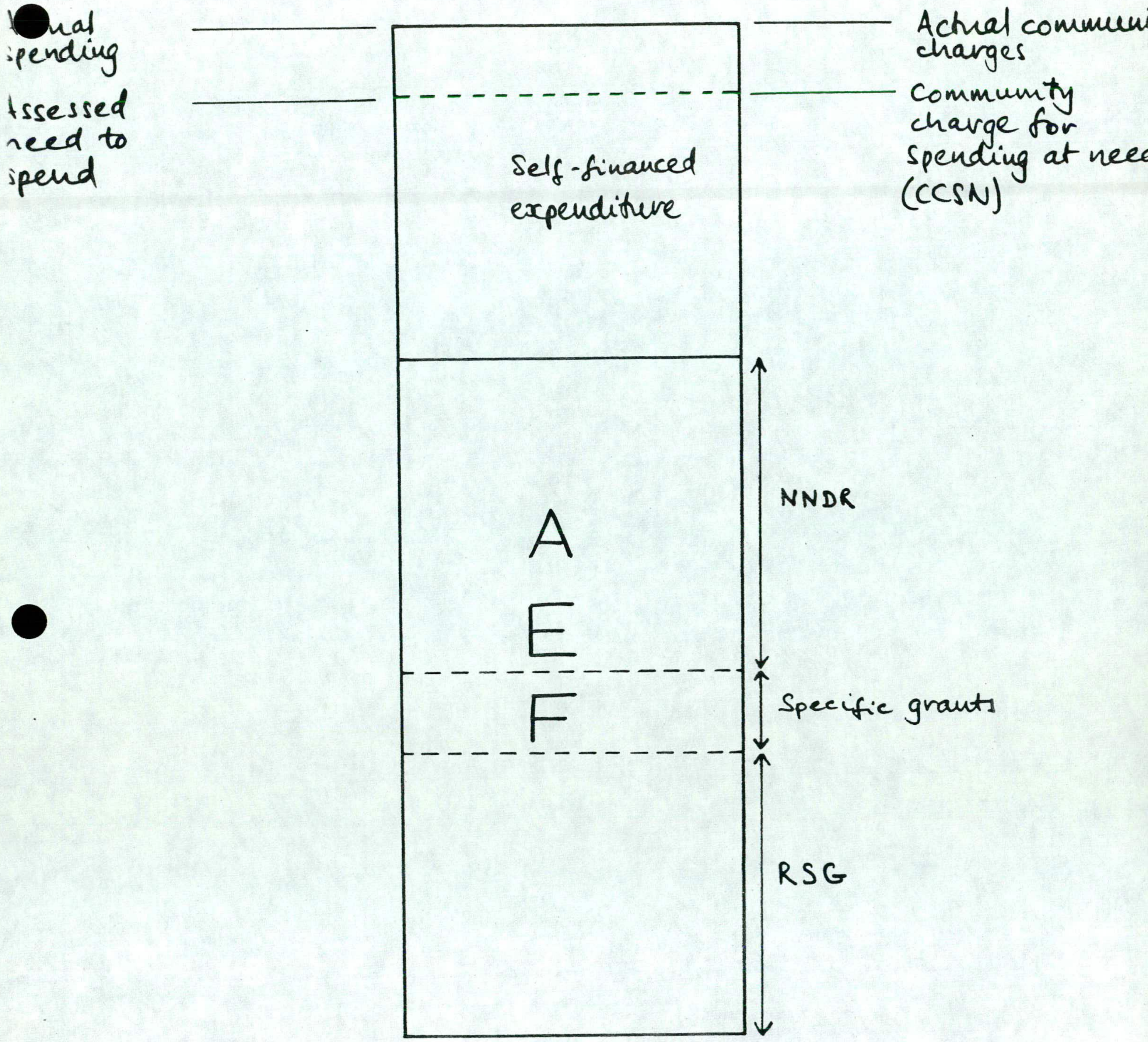
ANNEX A

TREATMENT OF LA CURRENT EXPENDITURE IN 1989 SURVEY: PROPOSED TIMETABLE (ASSUMING A JULY GRANT ANNOUNCEMENT)

1989

Jan-Feb	Chief Secretary letter leading to agreement on procedures and baselines.
Mar-June	Official level discussions on changing needs with local authority associations.
May-June	Officials prepare and discuss papers, eg in PESC(LA).
June-July	Collective Ministerial discussion of: a. "Aggregate Exchequer Finance" (AEF) comprising the revenue support grant (RSG), the national non-domestic rate (NNDR) and certain specific revenue grants; b. aggregate needs assessment; c. (following from a. and b.) the community charge for spending at need; d. expected actual levels of community charge implied by different grant levels.
July	Announcement of AEF for 1990-91 together with the aggregate needs assessment and the community charge for spending at need.
Sept-Oct	a. Service split of aggregate needs assessment settled for 1990-91. b. Bilateral Ministerial discussions of specific grants in the Survey, for all three Survey years.
Oct	Business rates package and RSG for 1990-91 settled and announced for Scotland. Difficult to avoid parallel announcements on 1990-91 NNDR and RSG and aggregate specific grants for England and Wales. Environment departments begin formal consultations on RSG. Final decisions on specific grants for later years and projections of total LA self-financed expenditure, capital and current.
Nov	Autumn Statement.

Local Authority Current Expenditure Annex B



ANNEX C

COMMUNITY CHARGES IN SCOTLAND IN 1989-90

Facts

1. Average community charge (excluding water) is £281.

2. Average community charge (including water) is £301.

3. Range of community charges goes form £148 (Orkney) to £392 (Edinburgh City).

4. Increase in community charge over average domestic rate bill per adult in 1988-89 is 14% - an increase in real terms of 8%.

5. Spending in 1989-90 over 1988-89 showed an increase of 12% - an increase in real terms of 6%.

6. Some regions increased spending in 1989-90 by up to 13½% and Districts by up to 30%.

Implications

1. Local authorities have taken the opportunity to use the Government's community charge policy as an excuse to increase spending.

2. Increased spending not necessarily confined to high spenders, moderate spenders have spent up as well.

3. Only indications of restraint are where authorities have tried to keep charges below psychologically important levels. For example Edinburgh wanted to keep below £400.

4. Generally accountability has not obviously been improved. But there is no reason why it should.

- There are no elections in Scottish districts until 1992.

- Comparisons are blurred because of the "safety net".

- Difficult to compare the new system with the old domestic rating system.

VERSION OF 27 APRIL

PAPER A: FACTUAL BACKGROUND

Trends in spending and grant

In the first two years of the present government, local authority spending grew about twice as fast as GGE in real terms. From 1982-83, however, the system of targets and penalties led to a considerable slowing of growth, and the introduction of rate-capping contributed to a substantial real fall in spending in 1985-86. But the abandonment of targets and penalties for 1986-87 led to a substantial real increase of over 6 per cent, and the step change in teachers' pay meant there was a further significant real increase in 1987-88. Spending barely grew at all, in real terms, in 1988-89, as local authorities (like everybody else) underestimated the pick-up in inflation and most of the catching-up for restraint in the past, including on pay, had taken place.

2. This year, by contrast, the real increase in spending looks likely to be around 4½ per cent. There are a number of possible reasons for this. Local authorities may be catching up for last year's inflation, and budgeting on the basis that future inflation may be ahead of the GDP deflator. Also, the closedown of the old RSG system meant a more generous grant settlement than in most years, which local authorities know will be paid in full, as planned, irrespective of the level of spending.

3. In short, from 1982-83 to 1985-86, local authority spending grew more slowly than public expenditure as a whole (GGE excluding privatisation proceeds); but since 1986-87, it has grown significantly faster than GGE. And one of the key differences has been the easing of pressure through grant settlements.

4. Annex A gives the figures in detail.

Pressures on local authority spending in 1990-91

5. Local authority current spending is likely to show real growth in 1990-91. Our forecast of local authority spending is likely to be based on an assumption about the GDP deflator in 1990-91. The FSBR included a figure of 4 per cent but given that current RPI inflation is running close to 8 per cent, it is unlikely that E(LF) will accept a figure of 4 per cent in July. These papers assume that the forecast GDP deflator will be increased slightly before July - enabling us to use a more realistic figure and helping to maintain credibility in E(LF). The papers assume a GDP deflator of 5 per cent.

6. The main pressures on spending in 1990-91 are outlined in more detail in Annex B, but the major pressures will come from the following.

(a) Relative price effects.

The main impact will be through pay settlements that are above the assumed level of inflation of 5 per cent. In addition, manpower levels are likely to increase in certain areas (eg police). Pay accounts for about 75 per cent of local authority current spending, and is likely to account for an increase of about £500 million.

(b) Policy changes

The main policy initiatives include the additional costs of collecting the community charge (£100-200 million), the costs of transferring educational responsibilities from ILEA to the inner London boroughs (£100 million), and increased costs on personal social services (mainly as a result of the Disabled Persons Act 1986) (£100 million).

(c) Demographic changes

The main upward pressures are likely to be on personal social services and, in particular, on services for the elderly. Other pressures on community care, child abuse, poverty/homelessness, and AIDs will be partly off-set by lower unemployment, but can be expected to add to the overall pressure for increased spending on personal social services. In total they could all add about £100 million.

In total these could amount to upward pressure on needs of up to about £1 billion.

7. Against these upward pressures, the Audit Commission has identified a number of potential savings through efficiency gains. It is difficult to judge how far we will be able to get departments to accept that these savings should be taken into account. The savings are unlikely to feed through into any estimates of actual local authority spending but they should feed into the estimate of the aggregate need to spend. We have identified savings amounting to a total of about £2 billion, but these are based on reports compiled over a number of previous years and some will have already been taken into account. Assuming that those already accounted for amount to about £1 billion, we might expect further savings of up to about £1 billion to be taken into account in the calculation of the aggregate need to spend. It is perhaps more realistic to expect colleagues to accept savings of about £½ billion.

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PAPER B: OBJECTIVES

General objective

The common objective for this year's settlement will be to get the community charge off to a good start. A number of Ministers will equate this with maximising grant, so that the CCSN is as low as possible, and actual community charges not too high.

2. Alongside this general objective, different Ministers will see different things as important.

Spending departments objectives

3. The spending departments' objectives for the settlement are fairly straightforward. They will want a high figure within the aggregate assessed need to spend for their particular service. They will argue that we must include realistic figures for the need to spend, and that these should be built up from a "bottom-up" approach based on individual services. They will see this as the best way of achieving a higher figure for their service. Both we and (probably) DOE will argue that the aggregate should be set in the light of what the Government can afford but we can expect the usual arguments against this approach. This year, with the introduction of a new local authority finance regime and new Survey procedures, we can expect a more determined effort from the various service departments.

4. At official level DOE will be chairing the Settlement Working Group (SWG) which will report on changes affecting the aggregate need to spend in 1990-91 to the Consultative Council on Local Government Finance (CCLGF) (which is where Ministers meet local authority elected representatives). The SWG will focus on the Local Authority Associations views on changing needs but service departments are likely to take the opportunity to build on the work of the SWG to argue their own case for higher needs on their particular service. They will be concerned about two

points. They will wish to see both a larger total and a greater share of the total for their service. DES can be expected to take the lead - indeed they are already attempting to co-ordinate a paper from the main service departments for the E(LF) discussions. This is likely to argue for the "bottom-up" approach and will increase pressure for a higher total.

5. In short, the service departments will want the best of all possible worlds - a politically acceptable low community charge, financed by high grant, so that spending on their service can also be high.

6. Both we and DOE will need to stress the importance of continuing to restrain local authority spending. Others may argue that the community charge philosophy, and the introduction of the new planning total, suggests that the Government may no longer be concerned about total local authority spending. We will therefore need to reassert the point that total spending does matter and that the Government's overall public spending objectives must take priority.

DOE Objectives

7. DOE will be in a rather different position.

8. It is likely that DOE will be most concerned about the aggregate need to spend rather than about actual spending. This is the total that will be used to calculate the community charge for spending at need (CCSN). The aggregate need to spend less Aggregate Exchequer Finance (AEF) will lead to the CCSN. The CCSN will be the Government's estimate of what it thinks local authorities should be charging. It will be the figure that the Government will wish to emphasise in the run-up to the introduction of the community charge on 1 April 1990. DOE will be continually stressing that this is the figure that it believes the prudent local authority should be setting. It is therefore likely that, in discussions on AEF, DOE will be focusing on what this means for the CCSN. Their prime objective is likely to be a figure for the CCSN that will be seen as realistic.

9. DOE will however face a conflict. There are arguments for both a high and a low CCSN. A low CCSN will be held as politically important for a successful introduction of the community charge, but it must be realistic (a reasonable number of authorities will need to set their actual CCs below the CCSN). They will need to balance the arguments.

10. Given that it is the CCSN that will be foremost in their mind, there are a number of issues they will need to consider.

(a) They will want the CCSN to be presentationally acceptable. It is unlikely that they would accept a CCSN that was much higher in real terms than the equivalent figure in 1989-90 because this might be held as a criticism of the Government's community charge policy.

(b) On the other hand a lower CCSN might lead to a bigger difference between the CCSN and actual community charges. DOE will not want this gap to be too large because they will have to explain any difference by overspending. Too low a CCSN will discredit the concept. They may not therefore wish to see the CCSN set at too low a level.

(c) If they think that the Treasury is going to be tough on grant, then they will support our wish to see a lower aggregate need to spend. But again they would not support an unrealistic figure, because they have to justify it to the local authority associations. They may well, however, be an ally against other departments' desires to push up the aggregate need to spend.

(d) They will want some measure of the grant percentage to be no worse than it was in 1989-90. They will want to be able to claim that Government support to local authorities has improved, or at the worst, has remained unchanged. Annex C discusses the grant percentages further.

Treasury Objectives

11. Notwithstanding the changes in local authority finance and in the definition of the planning total, the two key objectives for the Treasury are the same as ever.

- For reasons of macroeconomic policy, we want to keep any increase in actual local authority spending to a minimum.

- And within that, we want to keep the size of the AEF envelope, ie grant, to a minimum, so as to keep down the burden on the taxpayer. This means that we want the CCSN to be as high as politically feasible.

12. These two objectives go hand in hand. Indeed, the level of grant is our main weapon to influence the level of local authority spending. Thus the central objective is a low figure for AEF.

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PAPER C: STRATEGY

Approach to the discussions

The way the discussions are handled could have an important bearing on the outcome.

2. Specifically, a number of Ministers will come to E(LF) expecting discussion to focus on the actual level of community charges that will result from the settlement. And obviously that will be high in everybody's minds throughout. But it cannot possibly help us for the discussions to centre on that.

3. Focusing on the doorstep community charge will lead to immense pressure for more grant, so that, for any given level of spending, the community charge is lower. This puts us immediately on the defensive. We can argue that local authorities will set whatever community charge they had in mind anyway, and that extra grant will simply mean higher spending. But we cannot refute the proposition that some authorities will use extra grant to reduce the community charge.

Dangers of actuals

4. It will be important, therefore, to focus the discussions, as far as possible on the numbers Ministers actually have to decide and take responsibility for: the aggregate need to spend (NTS), AEF, and the CCSN. We suggest that you might talk to the Prime Minister about this in advance (see paper D on tactics). The points are:

- clearly it is vital to get the community charge off to a good start, and the settlement must be defensible, to that end;

- but Ministers do not fix the doorstep community charge - that is what accountability is all about;

- so what we have to do is to concentrate on the numbers we do control - the NTS, AEF, and the CCSN;

- remembering that we have the fallback weapon of community charge capping for local authorities.

5. The aim is thus to focus the debate on needs, rather than actual spending and charges. The rest of this section therefore looks first at the arguments on needs, and then at arguments on actual community charges.

The matrix on needs

6. The relationship between the NTS, AEF, and the CCSN is straightforward. The CCSN is the difference between the need to spend and AEF, divided by the total number of community charge payers (assumed at 36 million for 1990-91). Looked at another way, if the CCSN is fixed, the difference between that and the NTS has to be met by grant.

7. Thus discussions will centre on a matrix which shows a range of figures for the need to spend, a range for AEF, and the figures for the CCSN which would result from the various combinations of the two. A first shot at such a matrix is below.

Values for CCSN (£) in 1990-91

		Need to spend (£bn)					
		31	31.5	32	32.5	33	33.5
	22	250	264	278	292	306	319
AEF	22.5	236	250	264	278	292	306
(£bn)	23	222	236	250	264	278	292
	23.5	208	222	236	250	264	278
	24	194	208	222	236	250	264

In terms of objectives,

- we want a low AEF, and preferably low NTS - that means an outcome as near the top of the matrix as possible, preferably over to the left;

- spending departments will want a high NTS, financed by grant - that means an outcome as far over to the right as possible, preferably towards the bottom;

- DOE, with their balance of objectives, may want to end up somewhere in the middle.

8. In practice, the element in the equation with least flexibility is likely to be the CCSN. Political considerations will put a cap on this, and the maximum politically acceptable level may well emerge fairly early on in the discussions.

9. We think there is absolutely no case for the CCSN to be below the figure DOE have quoted for this year, of £240, in money terms (though this has been worked out on slightly different assumptions from the CCSN, notably a larger population). Uprating that for inflation at 5 per cent would give a figure of £252. Beyond that, you could argue that, if colleagues see a case for a real increase in the need to spend, some of the extra cost of that should properly fall on the chargepayer. But there seems little prospect of the CCSN being set above the cash level of domestic rates per head in 1989-90, of around £275. A figure of £260 may be a more realistic upper limit.

10. This constraint means that, above a certain limit for the CCSN, additions to the NTS have to be paid for through extra grant. In practice, it will therefore be vital to discuss the NTS and AEF together - otherwise, Ministers may become hooked on a very high figure for the NTS, which would mean a high outcome for AEF. Here, we have looked at the arguments on the two separately, and then pulled together the bull points of our case.

Need to Spend

11. The level of the need to spend (NTS) could be set in two ways:

(a) based on aggregate measures of spending in 1989-90, either the need to spend (aggregate GRE), or actual local authority budgets;

(b) by a "bottom up" approach, which seeks to work out the amount that ought to be spent by an efficient authority on each element within the needs assessment, service by service, and adds them all up. This is the approach favoured by the spending departments, and they are working up a paper for E(LF).

We think you should be able to see off the "bottom up" approach, be stressing how useful it will be when it comes to discussing the service distribution in the autumn, and ignoring it for now. The more difficult question is whether the NTS should be based on a percentage increase over needs (as we shall argue) or over budgets (as spending departments will argue). We should be able to succeed in basing it on needs, on the grounds that the other approach validates local authority overspending. But in practice, the level of budgets in 1989-90 will limit the room for manoeuvre on the NTS - the cash figure for budgets in 1989-90 may turn out to be a floor, politically, under the NTS.

12. Simply uprating needs by 5 per cent and adjusting for the factors covered in Annex E, would give a total of £31.7 billion. This would be a very good outcome if it could be achieved. A more realistic objective might be to limit the real growth of the NTS to ~~2½~~ around 3 per cent. This suggests a figure of £32·1 billion, which would imply a ~~small~~ cash increase, but a real cut, on 1989-90 budgets (adjusted for functional changes).

13. A number of colleagues are bound to argue for more substantial real increases, pointing to:-

- the upward pressures on their particular service, and on local authorities generally;

- the case for greater realism under the new system, particularly since the Government has to determine the "need" to spend to deliver services, and the NTS could be subject to judicial review;

- the need to get the community charge off to a good start.

Against this you could argue:

- there is absolutely nothing in the new system which implies a step change in the amount local authorities need to spend to deliver services;

- indeed, the community charge is about getting spending down, not an excuse for putting it up - to suggest the reverse would give all the wrong signals to local authorities;

- the prospect that the NTS will lever up actual spending: the traditional overspenders will ignore it, but, as the Scottish experience shows, some authorities which have traditionally spent below assessed need may take the opportunity of the new system to move up to that level - we shall look at this further in modelling the impact of different levels of NTS on different authorities;

- on upward pressures, local authorities have had time to prepare for most of the new functions coming through in 1990-91, and any supposed extra costs should be met by use of the balances they have already built up for the purpose - not reflected in a yet higher NTS and higher grant;

- there is still considerable overspending and inefficiency, (where you could refer to the Audit Commission's work);

AEF

14. There are two sets of arguments for keeping grant down: first, based on the share of the NTS that should properly be financed by the taxpayer; and second, on the influence of grant on actual spending.

15. On grant and needs:

- there is no reason for a higher level of taxpayer support for local authorities;
- indeed, the long term objective should continue to be less taxpayer support and more local authority accountability;
- there are actually political dangers in putting in excessive grant - the Opposition will describe any apparent new generosity to local authorities as the Government running scared and "bailing out the poll tax";
- the public expenditure position means that high levels of grant, within the NPT, cannot be afforded, or, at any rate, would seriously limit any room for manoeuvre elsewhere in the Survey.

16. The arguments on grant and spending are:

- higher grant leads to higher actual spending - this is the lesson of the change between the mid-1980s (tough grant settlements - real cuts in spending) and more recent years, especially 1989-90, including the Scottish experience of 1989-90, where a grant increase of 5.5 per cent, ahead of that for England or Wales, did not prevent spending rising by 11.6 per cent;
- higher grant is no guarantee whatever of lower actual community charges: many local authorities will have a "target" for the community charge, and higher grant will simply be added to that, leading to higher spending; in any

case, the relationship between grant and community charges will be obscured by the use of balances, and other income - in Scotland, community charges rose even faster than spending;

17. In assessing the appropriate objective for AEF, we have looked separately at the NNDR and grant (taking RSG and specific grants together).

18. The level of NNDR is more or less given. Mr Ridley has said that the amount raised from non-domestic rates paid by the private sector and nationalised industries will be broadly the same, in real terms, in 1990-91 as in 1989-90. The real terms increase should follow the September RPI - this helps us since that will be significantly higher than the GDP deflator for 1990-91, which, we shall be arguing, is the appropriate measure of inflation for spending purposes. The other element in the NNDR is the Government contribution in lieu of rates, which is also likely to be buoyant. So there should not be much to negotiate about, unless Mr Ridley argues for a cut in the burden on the business ratepayer. We think you should resist this, but Mr Ridley will probably concentrate his fire on other things. A preliminary estimate suggests that the amount of NNDR may be around £10.3 billion.

19. As far as grant is concerned, the total of RSG and specific grants within AEF in 1989-90 amounts to around £12 billion. This represents, in effect, the taxpayer's support for local authorities.

20. AEF in 1989-90 would be around £21.6 billion. Increasing in line with 5 per cent inflation would give a figure of £22.7 billion. With the NNDR buoyant, this would imply a small cash increase in grant of £0.4 billion but a small real cut.

21. However, with the CCSN held constant in real terms at £252 (producing around £9.1 billion), it would provide for an NTS above our target of £31.7 billion. So we believe that our target should be an AEF of £22.6 billion.

22. The fallback position could be to go for the 3 per cent real increase in the NTS, to £32.1 billion, and a CCSN of exactly £250, implying AEF of £23.1 billion (a 2 per cent real increase) and grant of £12.8 biullion (a 1½ per cent real increase).

23. With the NNDR given (certainly as far as the upper limit is concerned), any upward pressure on AEF means more grant, at the taxpayer's expense.

24. To summarise, the two possibilities we have suggested work out as follows:

Possible Settlement

	Target	Fallback
	£ bn	£bn
NTS	31.7	32.1
CCSN	9.1	9.0
AEF	22.6	23.1
(of which NNDR)	(10.3)	(10.3)
(grant)	(12.3)	(12.8)
Increase over 1989-90		
- AEF	+1.0	+1.5
- grant	+0.3	+0.8

25. It is worth noting - though unlikely to be relevant in practice - that the safety net effectively puts a floor under AEF. Basically, it ensures that, if an authority simply increases its budget in line with inflation, it will not have to raise any more, in real terms, from the domestic rate payer/charge payer in the first year of the new system than in the last year of the old system. In effect, this means that, assuming budgets do not fall in real terms, AEF cannot fall either. This floor is likely to be of the order of £22½ billion. The safety net will have a more important bearing on the distribution of grant, and this is considered in Annex D.

26. As you know, the aim is to settle specific grants within AEF before the July settlement, as far as possible. We shall have to decide how best to handle specific grants when the bids come in.

If there is strong upward pressure, it may be to our advantage to discuss them collectively in E(LF), with support expected from Mr Ridley. But we shall have to judge that as we go along.

27. To sum up, the bull points of the Treasury's case on the NTS/AEF/CCSN nexus are:

- we need to stick to the ten year policy of downward pressure on local authority spending;

- the community charge is designed to help this, not an excuse to backtrack;

- higher grant would lead to higher spending, not lower community charges;

- a reasonable settlement would be for Exchequer support to remain constant in real terms, so that a small real increase in the NTS can be achieved with no real increase in the CCSN.

Actual community charges

28. The implications of the settlement for the community charges that authorities actually decide to levy are bound to feature in the discussions. As noted above, some colleagues may even feel that the discussion should focus on the effects of the settlement on actual community charges.

29. Colleagues are bound to ask what the settlement means for actual community charges. But a discussion on actual community charges is likely to mean that we will be forced into a more generous settlement. Local authority budgets in 1989-90 (adjusted for functional changes) amount to £31.6 billion, and it could be argued that a realistic forecast of actual spending in 1990-91 would be about £34.1 billion ie a real increase of 3 per cent. Using an AEF figure of £23.1 billion (our fallback position) this would imply an average community charge of £306. This is 12 per cent higher than the rate bill per head in 1989-90 of £274. However this figure (£274) assumes that local authorities use balances of about £600 million to finance spending. (This is the amount by which local authorities plan to reduce balances in 1989-90). If we assume that a similar reduction of balances takes

place in 1990-91, the forecast of the average community charge would be reduced to £290. This would represent a 6 per cent increase on 1989-90.

30. We are sure that generally it is in our interests to minimise any discussion of actual community charges, and to concentrate on the figures that the Government can control, not those it can't. But it is unrealistic to suppose that the discussion will stop there. And so it is important to bear in mind the arguments that we do have at our disposal if colleagues' concerns about the level of actual community charges begin to dominate.

31. There are two:

(i) our ability to cap community charges, to protect the charge payer; and

(ii) our ability to shift the distribution of grant to benefit some types of authority (eg those in Outer London, the South).

Each addresses different concerns. The first relates to the prospect of very high community charges in some individual areas. The second to the fact that the financial benefits the new system will eventually bring to the South and Outer London will be delayed for several years by the slow phasing out of the safety net (see Annex D). We shall almost certainly want to use (i); we may also want to use (ii) - though probably not without bilateral discussions with DOE beforehand.

32. The practical arguments for <u>community charge capping</u> are strong. Community charges will tend to be particularly high in Inner London: colleagues are likely to be especially worried about the political (and social) implications of this. Charge capping will help to protect the chargepayer in these areas, and to contain the social problems caused by the introduction of the new system. Capping may also be necessary simply to prevent excessive overspending - particularly in the early years of the new system, before the accountability effect of local elections can be brought to bear.

33. Some colleagues may argue that capping would be at odds with the logic of the new system - which is that local authorities should make their own decisions about the level of local taxation and that Central Government should not interfere. It is in our interests to argue strongly against this view. We need to emphasise that:

- of course, the main aim of the new system is to enhance local authorities' accountability and to make sure that local decisions on the level of spending are properly reflected in the level of the local taxation.

- but accountability will not bite immediately, and the Government cannot walk away from its ultimate responsibility to protect charge payers from irresponsible local authorities, where an authority sets its charge at a ridiculously high level or where it plans to finance excessive overspending.

- we decided to include a charge capping power in the legislation because of this responsibility. We must be prepared to use it now, to protect local people and to prevent serious social consequences of local authority folly.

34. The other argument at our disposal - <u>varying the distribution of grant</u> - is likely to prove less important. DOE are concerned that the safety net (which will phase in losses and gains in authorities' income as we move from the old to the new systems) will delay gains for the South and Outer London. They may press for more of these gains to come through in 1990-91, with the cost met by extra grant, rather than by altering the phasing in of losses for authorities in Inner London and the North.

35. If the prospect of relatively high community charges in Outer London and the South is a major concern for DOE, it may be that we could secure a cheaper settlement overall by agreeing to finance some of these gains directly: the alternative might be having to make a larger addition to AEF to reduce community charges in general. It is however, difficult to estimate the likelihood that we may have to do a deal of this kind.

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PAPER D: TACTICS

If you agree with our analysis above, there are then questions about the general approach and the tactics, that will produce the most successful outcome.

2. On the general approach, there is the usual choice between, on the one hand, starting with very low proposals for NTS and AEF, in the expectation of being bid up to where we expect to end up, and, on the other hand, starting only slightly below the likely outcome. In the circumstances of this year's discussions, we recommend the latter approach. If you appear to be taking an unrealistic position at the outset, the credibility of our arguments could be undermined, and the eventual outcome worse than it would otherwise have been.

3. On tactics, there are four audiences to consider: the Prime Minister; Mr Ridley; the spending Ministers; and the 'neutrals' on E(LF). Several approaches seem to be open to you:

- take an independent Treasury line in E(LF);

- seek to persuade the Prime Minister of the Treasury case in advance of E(LF)'s first meeting; and

- attempt to reach a broad measure of agreement with Mr Ridley, also in advance of E(LF).

No doubt you will wish to consider which approach is most promising - the second and third could go together.

4. The Prime Minister has, we understand, decided to hold a meeting with you, the Chancellor, Mr Ridley, and Mr Parkinson before the second Bank Holiday in May. This meeting may just be intended to bring her up to date on the issues that have to be decided in E(LF); but with some preparation beforehand, it might be possible to reach broad agreement between the main parties before E(LF) meets, either at that meeting or shortly afterwards.

5. We would see some advantage in such an early agreement, if it proved possible. For that to be the case, it would of course be necessary to find out more about Mr Ridley's thinking quite soon. Mr Ridley is likely to be our closest ally; certainly none of the spending Ministers will offer any help. And once the discussions have passed to E(LF), we may well find ourselves heavily outnumbered.

6. If the major issues do have to be resolved in E(LF), it may be worth taking some of the 'neutrals' through the decisions beforehand. Mr Parkinson may have some special influence, as chairman of E(LA), and he is a potential ally. You may also want to have a brief word with others who may be sympathetic: perhaps Mr Wakeham, Mr Fowler, and Mr Newton. Perhaps the key point to get across is that, although it will be important to get the community charge off to a good start, it will be equally important to maintain the continuity of the Government's policy of reducing local authority spending.

7. We do not however, see any point in pre-meetings with any of the spending Ministers.

ANNEX A

LOCAL AUTHORITY SPENDING AND GRANT, 1981-82 TO 1989-90

	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1988-89 (ex Polys)	1989-90
GDP deflator	74.281	79.54	83.225	87.337	92.12	95.219	100	107.25	107.25	113.149
Relevant Expenditure (O)	19,933	21,765	23,005	23,900	24,039	26,370	28,704	30,877	30,042	33,156
Rel.Exp.(Real) m pnds	26,835	27,364	27,642	27,365	26,095	27,694	28,704	28,790	28,011	29,303
Real change %		1.97	1.02	-0.01	-4.64	6.13	3.65	0.3	n.a.	4.61
GGE(ex pp)(Real) bn pnds	162.9	167.3	170.1	174.9	174.6	177.3	177.0	173.5	173.5	176.4
Real change %		2.7	1.67	2.82	-0.17	1.55	-0.17	-1.98	-1.98	1.67
AEG(S) m pnds	10,900	11,500	11,800	11,900	11,800	11,800	13,000	13,775	12,940	13,575
AEG(S)(Real) m pnds	14,674	14,458	14,178	13,625	12,809	12,392	13,000	12,844	12,065	11,997
Real change %		-1.15	-1.94	-3.9	-5.99	-3.26	4.91	-1.2	n.a.	-0.5
AEG(O) m pnds	10,900	11,200	11,500	11,900	11,785	11,961	12,744	13,204		13,575
AEG(O)(Real) m pnds	14,674	14,081	13,818	13,625	12,793	12,562	12,744	12,311		11,997
GRE m pnds	17,194	18,358	19,156	20,003	21,237	22,952	24,237	26,015	25,180	27,662
GRE(Real) m pnds	23,147	23,080	23,017	22,903	23,054	24,104	24,237	24,256	23,478	24,447
Real change %		-0.3	-0.3	-0.5	0.7	4.6	0.6	0.0	n.a.	4.1
Grant percentage (S)	59.1	56.1	52.8	51.9	48.7	46.4	46.4	46.2	n.a.	43.3
Grant percentage (O)	54.9	51.7	49.8	50.0	49.0	45.4	44.4	42.8	41.2	n.a.

ANNEX B

PRESSURES ON LOCAL AUTHORITY SPENDING IN 1990-91

There will be a number of upward pressures on local authority spending in 1990-91 as a result of new policy changes (based on central government initiatives) and the rising cost of existing policies (because of demographic factors such as an increased elderly population and pay pressures). The main pressures in each of the main services, (other than pay which is covered separately), and a very crude assessment of the likely cost, are as follows:

(a) **Education**

The number of school children is projected to decline over the next few years but given the tendency towards a reduction in class sizes the number of teachers is unlikely to decline. As long as a teacher shortage exists the main pressures will be for increased pay (see later paragraph on pay). The transfer of education responsibilities in inner London from ILEA to the inner London boroughs is unlikely to reduce costs. Even though ILEA is considered a large over spender the cost of education in inner London is likely to be higher in 1990-91. A crude guess suggests that additional spending could be of the order of £100 million. Further pressure on educational needs, from the national curriculum for example, could add another £10-20 million.

(b) **Transport**

On roads there will be increased pressure for higher spending on structural maintenance. Some of this pressure could be removed by capitalisation, or from re-classifying the expenditure to capital spending, but if neither of these changes occur increased spending could amount to anything up to £150 million, say likely to be about £50 million.

(c) **Law and Order**

The main pressures within the law and order programme will arise on the pay front (police, probation services and magistrates courts) and these are covered later. Additional pressure will also arise for increased manpower. For the police this is likely to amount to an extra 1 per cent (£40 million), so law and order in total could add about £50 million.

(d) **Personal Social Services**

Demographic changes could lead to additional spending of about £30-40 million, mainly concentrated on the elderly. Pressures arising from community care policies could add a similar amount but this could be larger if action on the Griffiths report is implemented. Other pressures, for example on child abuse could add a further £20-30 million. Additional pressures will also arise on poverty/homelessness and AIDs but these could be offset in part by falling unemployment. A number of policy changes could lead to higher spending - Disabled Persons Act (up to £50-£150 million), Children Bill (£5 million), Data Protection Act (£2 million) and other changes such as improved standards in residential care, more training, etc. (£10-20 million). In total increased spending on personal social services could amount to up to £300 million, say likely to be £200 million.

(e) **Other environmental services**

Community charge collection costs will be higher than the collection of rates, this could amount to between £100-200 million. Other pressures will arise from improvements in air pollution systems (£20 million), improvement in waste control systems (£20 million), and possibly increased responsibility as a result of the privatisation of regional water authorities. (£10 million).

2. On the pay front the main groups, and a crude assessment of the likely cost are as follows:

(a) **Teachers**. 1989-90 settlement 6.3 per cent. May be able to hold 1990-91 settlement to inflation rate in Autumn 1989. Therefore likely to be 5-7 per cent.

(b) **Police**. Based on average earnings in the 12 month period to May. Likely to be about 9 per cent from 1 September 1989. Assume a similar increase 7-9 per cent from 1 September 1990.

(c) **Local authorities administration and clerical**. Asked for 12 per cent from 1 July 1989. Possible outcome 8 per cent. Hopefully lower (as inflation comes down) from 1 July 1990, say 5-6 per cent. Pressures to keep community charges down (ie lower LA spending) should help to reduce settlement.

(d) **Local authority manuals**. Likely to be a similar outcome to (c).

The size of the pay bill in 1988-89 for the four groups was £7.2 billion for teachers, £3.1 billion for the police, £6.2 billion for administration, and £3.2 billion for manuals. Assume these go up by the amounts indicated above in 1989-90. If we then assume spending in 1990-91 goes up in line with inflation at 5 per cent, the additional costs of the above scenario in 1990-91 would be about £150 million (teachers), £100 million (police), £100 million (administration) and £100 million (manuals), giving a total of about £500 million.

3. Taken together all these pressures could lead to additional spending of the following amount:

	£ million
Education	120
Transport	50
Law and Order	50
Personal Social Services	200
Other Environmental Services	200
pay	500
Total	1,120

4. Against this the Audit Commission has identified a number of potential savings in local authority current spending. In total they amount to about £2 billion; the main services affected are as follows:

				1990-91 Prices
(1)	Education in secondary schools - non teaching costs (productivity schemes for classes, etc).	£40 m	(1984)	£53 m
(2)	Savings on secondary school teachers	£160 m	(1986)	£197 m
(3)	Refuse collection methods	£134 m	(1984)	£180 m
(4)	Saving energy in local government buildings	£135 m	(1985)	£172 m
(5)	Reducing administration costs in council housing	£100 m	(1986)	£123 m
(6)	Further education value improvement opportunities	£40 m	(1985)	£51 m
(7)	Council house maintenance	£467 m	(1986)	£576 m
(8)	Cash flow management in local government	£100 m	(1986)	£123 m
(9)	Local authority roads (improvements in maintenance)	£60 m	(1986)	£74 m
(10)	Improving vehicle fleet management (pooling vehicles etc)	£86 m	(1984)	£116 m
(11)	Improving supply management	£150 m	(1984)	£202 m
(12)	Improving highways agency arrangements	£66 m	(1987)	£78 m
(13)	Improving highways maintenance (winter)	£15 m	(1988)	£16 m
		TOTAL		£1,961 million

5. Some of these savings will have been achieved already. Up to 1987-88 individual auditors identified savings of about £750 million and estimated that out of this total local authorities had achieved savings of £220 million. Assuming that the pace of improvement has accelerated further since 1987-88 it is possible that out of a total of available savings of £2 billion local authorities may have achieved savings of £1 billion. Thus further savings of up to £1 billion can still be achieved.

6. In addition we will be seeking to reduce the aggregate need to spend by £250 million as a result of the change to superannuation costs, from 1 April 1990 the inflation element of local authority pensions will no longer be paid from the collection fund. Instead they will be paid from the Pension Fund. As these funds are running surpluses local authority superannuation costs will be reduced.

7. Finally some of the changes to the Revenue Support Grant baseline should be reflected in reduced needs. The reductions amount to about £500 million and cover the Housing Revenue Account, Mandatory Student Awards etc.

ANNEX C

GRANT PERCENTAGES

Under the new local authority current financial regime there are three grant percentages that will be relevant:

(a) Aggregate Exchequer Finance (AEF) as a percentage of the aggregate need to spend;

(b) Total Government Support (including NNDR) to local authorities as a percentage of total local authority current spending;

(c) Total Government support (excluding NNDR) to local authorities as a percentage of total local authority current spending.

2. The grant percentage at (a) will be derivable from the figures announced in July. It is unlikely to change substantially between July and November. The aggregate need to spend could change at the margin, as a result of bilaterals in September/ October, and hence the percentage could change slightly. This is the figure most closely analogous to the current grant percentage used by DOE (ie AEG as a percentage of relevant expenditure). But since AEF includes NNDR payments it is not directly comparable and both DOE and the local authority associations will claim that the NNDR payments are their own money.

3. For the same reasons DOE and the local authority associations will argue that (b) is misleading,. (b) will produce a high percentage, over 70 per cent in 1989-90, but DOE may resist attaching too much importance to the figure because of likely criticism from the local authorities themselves.

4. DOE will most likely want to focus on (c). They will have an objective in mind, probably something above 50 per cent. Neither (b) nor (c) can be derived in July at the time AEF is settled. DOE are however likely to try and anticipate what figure for (c) is implied by the grant settlement in July.

5. Historical figures for the various grant percentages are as follows:

	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90
AEF as a percentage of aggregate need to spend						
Government support (including NNDR) as a percentage of total local authority spending.				[Figures not yet available]		
Government support (excluding NNDR) as a percentage of total local authority spending						

ANNEX D

SAFETY NET

1. In the first year of the new system of local government finance, the Government is committed to operating a 'safety net' which will limit changes in the distribution of grant and non-domestic rate income between LAs. In broad terms, the safety net will ensure that the burden on domestic taxation (domestic rates and community charge) in any LA area is the same in real terms in 1990-91 as in 1989-90, assuming that the LA's spending also stays constant in real terms.

2. The purpose of the safety net is to prevent major changes in the distribution of grant and non-domestic rate income from disturbing LA finances in the first years of the new system. These changes are a consequence of moving from a system in which LAs are able to subsidise over-spending from the revenue paid by non-domestic ratepayers, and from a system in which the Government compensates LAs so that they only have to raise the same rate poundage for a given level of spending, despite variations in rateable values.

3. On current plans, the safety net will be phased out over the five years to 1994-95. By then, roughly £1 billion of grant and non-domestic rate income will have moved from LAs that are high spending or have low rateable values to LAs that are low spending or have high rateable values. In general, the losers from these distributional changes will be LAs in the North/Inner London, and the winners in the South/Outer London. It is currently planned that the safety net will be self-financing: as we hold up the losses for Inner London etc, so we will also delay the gains for Outer London and the South.

4. The safety net will have a major impact on the community charges actually levied in different areas gaining and losing from the new system in its first years. Some illustrative figures are set out below (these are based on LAs' 1988-89 budgeted expenditure which is the latest information readily available).

The table also shows the community charges that these authorities would have to levy if they spent at need under the new system, with the safety net in place (you will note that one of these figures is in fact negative).

	CC with safety net	CC without safety net	Payment into receipt from safety net	CCSN* +/- payment into or receipt from safety net
Inner London				
Camden	£438	£639	-£201	£49
Greenwich	£277	£589	-£312	-£62
Islington	£326	£480	-£154	£96
Lambeth	£277	£490	-£213	£37
The North				
Blackburn	£180	£251	-£ 71	£179
Barnsley	£189	£283	-£ 94	£156
Kirkles	£196	£289	-£ 93	£157
Rotherham	£215	£289	-£ 74	£176
Outer London				
Barnet	£305	£230	+£ 75	£325
Bromley	£222	£179	+£ 43	£293
Kingston	£267	£228	+£ 39	£289
Richmond	£325	£259	+£ 66	£316
The South				
South Bucks	£310	£235	+£ 75	£325
Cambridge	£288	£213	+£ 75	£325
Eastbourne	£268	£193	+£ 75	£325
Braintree	£263	£221	+£ 42	£292

*assumes CCSN of £250

5. There is a strong possibility that DOE (particularly Mr Gummer) will not want to see the gains that the new system of local government finance will eventually bring to Outer London and the South delayed by the safety net. (Under the safety net as announced there will be gains in 1990-91 for some authorities: those expected to benefit by more than £75 per community charge payer from the new system will gain so that only £75 of further gains are still to come. But all other gains will be phased in from 1991-92 at 25% a year, with the new system fully in place only in 1994-95. There will be small losses in 1990-91 for LAs losing under the new system to pay for the limited gains in that year; thereafter the losses will also be phased in at 25% a year).

6. DOE are, however, unlikely to want to finance quicker gains for Outer London, the South etc by quicker losses for Inner London and the North. They may press for the Exchequer to finance some or all of the gains, before the losses feed through.

7. It is difficult to estimate the danger that this issue will arise. There are also some important technical questions about how the Exchequer could finance gains for some authorities, but not others under the safety net. For obvious reasons, we have not yet discussed these with DOE officials.

8. The way in which we might handle pressure to put money into the safety net in this way would obviously need to be considered as and when it arose. But it may be that by satisfying some or all of DOE's concerns on this point - by using an addition to AEF to finance some gains for Outer London and the South - we could secure a better settlement overall.

9. There is one other point about the safety net which should be borne in mind. Because it will limit the burden of domestic taxation in any LA in 1990-91 to the same as in 1989-90 (for a given level of spending), it will also require us to provide a certain level of Government support - both for LAs individually and in aggregate. It would not be possible to keep the level of domestic taxation the same in real terms if we cut AEF significantly below its level in 1989-90 in real terms. DOE would then argue that such a cut would prevent us from meeting our commitments on the safety net.

10. This constraint is, however, not as restrictive as it may seem:

- First, given the other pressures on AEF this year it is unlikely that we will be pressing for a real terms cut in any case.

- Second, there is an issue as to what inflation indices should be used to calculate domestic taxation and LA spending in 1990-91 so that they are the same in real terms as in 1989-90. We are not committed on this point; and it may be to our advantage to argue for different inflation indices, as appropriate.

If (for the moment) we disregard the second point, then the safety net would seem to impose a floor on AEF of at least the notional total of AEF in 1989-90 (£21.6 billion) uprated by the GDP deflator, ie £22.5 billion.

ANNEX E

The aggregate need to spend (NTS) in 1990-91

Take total net GRE's for 1989-90		£27,662 million
Add specific grants within AEF		£ 2,849 million
Deduct adjustments to the baseline		
(i) Mandatory Student Awards	-£80 million	
(ii) Colleges	-£4 million	
(iii) Museums	-£3 million	
(iv) RFCs to HRA	-£348 million	
(v) CC preparation costs	-£55 million	
(vi) NNDR collection costs	-£34 million	
(vii) HB administration grant	+£19 million	
	-£505 million	
Total gross NTS in 1989-90	£30,006 million	
Increase for inflation 5 per cent	+£1,500 million	
Further upward pressure	+£1,000 million	
Scope for efficiency savings	-£500 million	
Reduced superannuation costs	-£250 million	
Total gross NTS in 1990-91	£31,750 million	

ANNEX F

1989 LOCAL AUTHORITY CURRENT SETTLEMENT: DATA UNDERLYING EXEMPLIFICATIONS: VERSION OF 27 APRIL

1. Need to Spend

Approach: take 1989-90 aggregate GRE; adjust for functional changes; add specific grants to get to gross needs.

	1989-90 £m	
Aggregate GRE	27,662	
plus HB administration grant	+ 19	
less RFCs to HRA	- 348	
Mandatory student awards (a)	- 80	
ILEA museums	- 3	
4 more polytechnics	- 4	
CC preparation costs	- 55	
Travellers' children (a)	- 8	
NNDR collection costs	- 34	
Lower superannuation contributions	- 250	
Adjusted net needs	26,899	
plus specific grants in AEF	2,849	×
Adjusted gross need to spend	29,748	×

(a) = provisional

2. Aggregate Exchequer Finance

(a) Revenue Support Grant

	1989-90 £m	
Rate support grant	9588	
plus positive adjustments		
- rate relief for EZs		+ 81
- rate rebates for disabled		+115
- reduction in HBA grant		+ 19
- universities rate (a)		0
Total positive adjustments		+215
less negative adjustments		
- abolition of LRT levy		-188
- 4 more polytechnics		- 4
- ILEA museums		- 3
- RFCs to HRA		-348
- mandatory student awards		- 80
- travellers' children		- 8
Total negative adjustments		-631
Adjusted RSG		9172

(a) Not yet known

(b) Specific Grants

	1989-90 £m
In-service teacher training	119
Education support	81
Travellers' children	0
Careers service strengthening	18
Shetered employment	15
National Parks	9
Urban Programme (current element)	55
Housing Benefit Administration (adjusted)	91
AIDs and HIV (a)	7
Social Services training (a) (elderly and childcare)	14
Magistrates'courts (b)	179
Probation (b)	179
Police (b)	1952
Civil defence (b)	17
Commonwealth immigrants	113
TOTAL	2849

(a) Baseline will be 0, because agreed for one year only.

(b) Loan charge elements to be removed.

(c) NNDR

	1989-90 (estimated outturn)	1990-91 (baseline, uprated by 2½ percent)
	£m	
Total NNDR	9669	9911
of which		
- collection costs	34	35
- city offset	36	37
- distributable amount	9599	9839

(d) Total AEF

	1989-90 (adjusted estimates)	1990-91 (baseline uprated by 2½%)
	£m	
RSG	9172	9401
Specific grants	2849	2920
NNDR	9599	9839
AEF	21620	22160

3. CCSN Population

Assume 36 million community charge payers. (36.4 million adults at mid-1987, plus 600,000 assumed population growth, less 600,000 exempt, less 400,000 deduction for 500,000 students paying only one-fifth of the charge).

4. Budgets, 1989-90

DOE's latest estimate is £29,461 million, for budgeted total expenditure in 1989-90, ie gross of financing items but net of specific grants. This implies £32,310 m, including specific grants with AEF.

Adjustment apply as follows:

	1989-90 £m
Net budgets	29461
less Mandatory student awards	-80
RFCs to HRA	-348
ILEA measures	-3
4 more polytechnics	-4
CC preparation costs	-55
Superannuation	-250
NNDR collection costs	-34
plus HB administration	+19
Adjusted net budgets	28706
Plus specific grants in AEF	+2849
Adjusted gross budgets	31555

L.A. CURRENT STRATEGY PAPERS.

FROM: A C S ALLAN
DATE: 2 May 1989

PS/CHIEF SECRETARY

cc PS/Paymaster General
Sir P Middleton
Mr Anson
Mr Monck
Mr Phillips
Mrs Case
Mr A J C Edwards
Mrs Lomax
Miss Peirson
Mr MacAuslan
Mr Potter
Mr Hudson
Mr G White
Mr Rutnam
Mrs Chaplin
Mr Call

LOCAL AUTHORITY CURRENT: TREASURY STRATEGY FOR E(LF)

The Chancellor has seen Mr Potter's note of 27 April to the Chief Secretary. He feels the Chief Secretary will need to be very tough in these negotiations. In this context, he was not much attracted to the fall-back on the safety net in paragraphs 39 and 40 (do not resist changes providing the cost can be contained within a given total for AEF).

2. He thought the Chief Secretary would also want to forge an alliance on as many issues as possible with Mr Ridley.

ACSA

A C S ALLAN