

| | |
|----------------------------|--------------|
| CH/EXCHEQUER | |
| REC. | 31 MAY 1989 |
| ACTION | No Copies to |
| COPIES TO | be taken |
| From the Private Secretary | |



10 DOWNING STREET

LONDON SW1A 2AA

26 May 1989

bt. 5/6
 [Ask
 Please if we
 can take one copy
 to
 give to
 LG]

pwp

Dear Roger,

LOCAL AUTHORITY GRANT SETTLEMENT 1990/91

The Prime Minister held a meeting on Thursday 25 May to discuss your Secretary of State's minute of 22 May about the local authority grant settlement for 1990/91. Those present were your Secretary of State, the Chancellor of the Exchequer, the Secretary of State for Energy, the Chief Secretary, Treasury, Sir Robin Butler, Richard Wilson, George Monger and Andrew Wells (Cabinet Office) and John Mills (Policy Unit).

I should be grateful if you would ensure that this letter is seen only by those with a clear need-to-know and that no copies are taken.

Your Secretary of State said that the settlement for 1990/91, the first year of the community charge in England, would be particularly important and difficult. The immediate issues for decision were the aggregate figures to be announced in July: the overall total of needs assessments, and the amount of Aggregate Exchequer Finance (AEF) which the Government would make available to finance that spending. These two figures would imply a particular community charge for spending at need (CCSN). But Ministers would also need to consider what local authorities were actually likely to spend in 1990/91, and the actual community charges which would result.

The paper set out four options for total needs and AEF, which had resulted from discussions he had held with the Chief Secretary. His own preference was for option D, with total needs set 4 per cent above 1989/90 budgets, plus an extra £200 million for community charge collection costs, and AEF set to produce a CCSN of £271. This was the only option which resulted in actual community charges below £300 for the range of possible actual expenditure figures considered in the paper.

He considered that option D represented a realistic and defensible settlement. But it would be premature to reach decisions before Ministers had had the chance to consider illustrative figures for the community charges which individual local authorities would need to levy. These

GRAY
 TO
 BRIGHT
 NOTE
 OF
 MTG
 25 MAY

would depend on detailed decisions on needs assessments and the transitional safety net, on which work was still in progress. Nevertheless he proposed to bring forward detailed exemplifications to E(LF) before he invited colleagues to take firm decisions on the level of total needs and AEF.

The Chief Secretary, Treasury, said that in deciding the level of total needs and AEF in 1990/91 the Government faced a difficult balance between ensuring acceptable community charges and restraining local authority spending. In the previous year the Government had agreed a generous settlement for 1989/90. It was now clear that the result had been substantially increased expenditure, up 9 per cent in cash terms. The position in Scotland, where the community charge had been introduced in April, was even worse, with expenditure up by 12 per cent. It was important not to repeat the same mistake in relation to England in 1990/91.

He therefore favoured option A in the paper, under which total needs would be set 7.5 per cent above the level of grant-related expenditures (GREs) in 1989/90, and AEF would be increased by 4 per cent, the latest estimate of the deflator. The CCSN under the option would be £264. The increase in total needs, which exceeded the likely rate of inflation, would ensure that many responsible authorities could still spend below their individual needs assessments. But holding AEF constant in real terms would restrain local authorities' spending decisions. He was concerned that any further addition to grant would result in higher expenditure rather than lower community charges.

In discussion the following main points were made:

a. It would certainly be desirable to keep the level of community charges in 1990/91 as low as possible and preferably below £300. Quite apart from political considerations, this could have important indirect benefits, for example on the Retail Prices Index (RPI). It would also be important to ensure that the basis on which the community charge was included in the RPI was technically correct and did not give rise to any overstatement of the index in 1990/91.

b. On the other hand, there would be substantial dangers in trying to restrain the level of the community charge by increasing the level of AEF in 1990/91. Local authorities were likely to take that as a signal that they could increase their spending, as in 1989/90, resulting in higher public expenditure and no reduction in the community charge. The Government might have to accept that the average level of charges in the first year would be on the high side, as local authorities took advantage of the introduction of the new system to push up their spending and rebuild balances. Only in later years would the increased accountability under the new system begin to bite on expenditure.

c. One approach to setting the total need to spend would be to identify how much of the increase in 1989/90 was due to external pressures on local authorities, such as pay settlements for the police and the teachers and the need to prepare for the community charge, and how much was due to their own decisions. That would allow the Government to set needs and grant at realistic and defensible levels. Such an approach was likely to be favoured by the Ministers responsible for the main local authority services.

d. On the other hand such a bottom-up approach to setting total needs would involve unacceptable risks. It would be much better to build on the total of GRES in 1989/90, which reflected a generous estimate of what authorities needed to spend in the current year, and were themselves substantially above GRES for 1988/89. Options A and B started from this base, adding increases of 7.5 per cent and 9.5 per cent respectively. There was no case for going substantially higher than that.

e. A considerable part of the increase in AEF under each of the options in the paper would come from the natural buoyancy of the national non-domestic rate (NNDR). It was right to take this into account in setting the level of needs grant and specific grants, since the alternative would be to provide local authorities with an excessively buoyant source of revenue. Nevertheless this could be controversial, and would require careful presentation. It might for instance be relevant to quote this increase in grant to local authorities over a longer period than one year, for instance taking 1989/90 and 1990/91 together on a 1988/89 base.

f. It would be important to look at exemplifications of the likely effects of the settlement on individual local authorities' community charges. Nevertheless Ministers would want to bear in mind that the pattern of charges could be influenced by decisions on the transitional safety net and on the method of dividing the needs total between local authorities. In this context it would be important not to refer to "needs assessments" for individual local authorities, which would give the impression that the Government was setting a minimum level of spending which was needed in each local authority area. A new and more appropriate term was needed and further consideration should be given to this.

The Prime Minister, summing up the discussion, said that it was clear that the 1990/91 grant settlement would be a sensitive one, and it would be essential to make it on a defensible basis. There were strong arguments for introducing the community charge at a reasonable level, preferably below £300. But it would not be right to seek to achieve this by making a substantial increase in Aggregate Exchequer Finance, which was more likely to result in

increased local authority spending than reduced community charges. Nor would it be right to set a total level of needs which validated the substantial increase in local authority expenditure in 1989/90. These considerations ruled out option D in the paper, which was clearly much too generous. On the other hand, option A was probably too tough.

It was therefore agreed that the Secretary of State for the Environment in consultation with the Chief Secretary, Treasury, should bring forward papers for E(LF) on the basis only of options B and C in the present paper. In E(LF) Ministers would wish to look at figures which showed how grant to local authorities and total needs assessments had moved over the period from 1988/89 to 1990/91, and this information should be included in the next paper. It would also be necessary to look at exemplifications of the likely community charge in each local authority area under the various options. The Secretary of State should also consider the term to be used for the individual assessments of local authority spending for grant purposes: it would not be appropriate to refer to "needs assessments" since that would give the impression of a minimum reasonable level of spending set by the Government rather than the maximum which they ought to be.

I am copying this letter to private secretaries to the other Ministers who attended the meeting and to the others present.

Yours,
Paul

PAUL GRAY

Roger Bright, Esq.,
Department of the Environment