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E(81)56

COPY NO 57

11 May 1981

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

LOCAL GOVERNMENT EXPENDITURE IN WALES: 1981/82

Memorandum by the Secretary of State for Wales

1. The Returns of Expenditure and Rates from Welsh local authorities have now been analysed. They indicate a small overspend is likely in 1981/82 in aggregate. The average general rate increase is shown to be about 13%, although there are wide variations between rating authorities. This paper sets out my proposals for dealing with the potential 1981/82 current expenditure overspend, and also comments on the proposals made by the Secretary of State for the Environment in relation to 1980/81.

Second Increase Order for 1980/81

2. The Second Increase Order for 1980/81 is the responsibility of the Secretary of State for the Environment since it relates to the former Rate Support Grant system which covers both England and Wales. The Secretary of State for the Environment's paper proposes that the decision on the restoration of all or part of the £200m withheld from the 1980/81 Rate Support Grant should be deferred until after outturn figures are available in the Autumn. Revised budgets submitted by Welsh local authorities last year indicated a planned overspend of about 1.6% but revised estimates for 1980/81 outturn received recently indicate a planned overspend in Wales of about 1%. On past trends these figures indicate that the actual outturn will be within or very close to the Government's target. I accept that it is not feasible to deal with England and Wales separately on this issue and that the decision on the amount of repayment should be deferred until the Autumn. However last year's withholding disproportionately disadvantages Welsh local authorities since their rateable resources are in aggregate proportionately lower than those of English authorities. This means that even though their planned expenditure was closer to the target, they suffer a more serious grant reduction from last year's withholding and close ending (2.54%) compared to England (1.51%).

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3. I have said that if actual expenditure in Wales were to be reduced consideration would be given to restoring some or all of the amount of grant withheld and I think we should inform the associations in England and Wales now of our intention to restore at least part of the withheld grant in the Autumn, the actual amount being dependent on the eventual outturn figures. Not to do so might well harden the attitudes of overspending authorities and discourage those who have made real efforts to reduce expenditure. At present the amount withheld in Wales is very nearly twice the amount of the planned overspend indicated in the revised estimates (£15m compared with £8m).

4. The Treasury, however, consider that there is no case for undertaking to repay grant at this stage in respect of 1980-81. The evidence available suggests that aggregate overspending may substantially exceed the amount of grant withheld.

#### 1981/82 Budgets

5. Budget returns for 1981/82 show that in aggregate Welsh authorities have budgeted for a volume of current expenditure 2.17% (£21m at November 1980 prices) higher than that provided for in the 1981/82 Settlement. In recent years the budgets of Welsh local authorities have in aggregate overstated the eventual volume of current spending by about 2%. The Welsh local authority associations have argued to me very strongly that because of this, the current returns should be interpreted as indicating that expenditure will be on target. Informal discussions between my officials and a number of local authority Finance Officers indicate that budget drift in Wales for 1981/82 would seem to be likely to be around 2%. A 2% level of budget drift would produce a volume excess of under £2m at November 1980 prices.

6. As regards the proposed change to cash planning, Welsh local authorities are planning in cash terms for an excess in net current expenditure of about £53m over the Settlement assumptions. This is made up of the raw 2.17% volume excess and the local authorities overall inflation assumption of 9.9% compared to the 6.8% assumption used in the RSG Settlement.

#### Corrective Action

7. In this paper the Secretary of State for the Environment discusses two broad options for holdback, of £300m and £900m respectively. The rationale advanced for the first figure is that it is comparable to the amount of holdback last year. That was about half the volume excess at revised budget stage. On that basis, the Welsh figure equivalent to the English £300m would be about £10m. The £900m is said to be more commensurate with the presently forecast level of overspending (ie gross volume) this year. On that basis, the Welsh figure would be of the order of £25m.

8. Either of these alternatives would be grossly disproportionate to the anticipated outturn on the basis of RERS and previous experience. With a budgeted volume excess very close to the likely extent of budget drift and with an anticipated volume excess after drift of only about £2m at November 1980 prices, I do not think it is desirable or necessary to take early withholding action in Wales. I propose therefore to delay taking formal corrective action through withholding until firm information on actual volume becomes available in the 1982/83 grant year. If any subsequent withholding is necessary this will be effected in the Second Supplementary Report in 1982/83. (The First Supplementary Report in November this year will deal solely with close-ending).

9. I appreciate that not withholding grant this year involves a small degree of risk that current expenditure will not be reduced to the target I have set, albeit that the planned volume excess is small. I have considered whether, notwithstanding my decision to defer withholding action until next year, I should call for revised budgets in the same way as the Secretary of State for the Environment proposed for England. I have concluded that this would not be appropriate if action on withholding is to be deferred until the 1982/83 grant year. I will however make it crystal clear at my next meeting with the Welsh Consultative Council on Local Government Finance at the beginning of June that my decision not to withhold grant at the First Supplementary Report Stage only represents a deferment of judgement; that if in the event current expenditure in aggregate exceeds my target, grant equal to the amount of the excess will be withheld next year. The message will also be conveyed very clearly in letters to individual authorities, which will give an indication of the consequences for each of them of not meeting the expenditure target.

10. I have noted that the Secretary of State for the Environment intends to make a Statement in the House about his proposals early in June. If he does so, I shall be obliged to make a Statement too. I would propose to keep it very short and low-key, observing that in view of the low predicted outturn and the assurances of local authorities that the spending target will be met in Wales I am deferring a decision on holdback until the Second Supplementary Report stage when outturn information will be available.

11. If in the event it becomes necessary to withhold grant the method would be similar to the methods set out in the Secretary of State for the Environment's paper but adapted to the percentage equalisation system I have adopted in Wales. I would also endeavour to ensure that as far as possible the amount of grant withheld from an individual authority was commensurate with its current expenditure excess and took account of its spending performance in relation to its GRE. (A possible method is at Annex A).

12. The Treasury, however, take the view that consideration should be given to requesting revised budgets, at least from the Welsh local authorities which are above target. In that event the Consultative Council would be warned that there might be a grant reduction in 1981-82 at First Supplementary Report if the results are not satisfactory. The rationale for this approach is

- (a) that the historical pattern of overbudgeting may not be a reliable guide to shortfall in 1981-82; when there is evidence of a tendency to increasingly tauter budgeting;
- (b) that failure to take this or similar action may undermine the credibility of the strategy proposed by Michael Heseltine in E(81) 52 for English local authorities.

The risk in calling for revised budgets is that some will show increases rather than reductions; but if this should happen it is arguable that it would be better for us to take account of the revised prospect in setting grant in the First Supplementary Report.

13. I understand that the Secretary of State for the Environment proposes that we should give warning to local authorities that there may have to be a further cut in grant percentage for 1982. I agree with this, although the expenditure performance of Welsh authorities would not in itself justify threats of Draconian cuts at this stage. Moreover, the cash limit assumptions we have adopted for the 1981/82 Settlement already imply an effective reduction of this year's grant percentage and further "tight" inflation assumptions for next year would effectively reduce the grant percentage even further.

14. I note that the Secretary of State for the Environment proposes to appoint members of leading firms of accountants as additional District Auditors to undertake audits of a selected range of authorities. I see no need to go down this path in Wales since it might well be counter productive. I have established a good working relationship with Welsh Local Authorities despite the differences in political philosophy with many of them and consider that in aggregate they will meet the expenditure target I have set without the need for recourse to such action. As regards waste, extravagance and value for money I believe I have a far better chance of achieving real results by discussion and encouragement, tactics which have so far worked reasonably well in Wales.

#### Conclusion

15. I therefore invite colleagues to agree that
- a. we should say now that we will restore at least part of the withheld 1980/81 grant in the autumn if the outturn figures justify it;

- b. withholding action in respect of Welsh authorities should be deferred, the position to be reviewed in the light of outturn information at the Second Supplementary Report stage;
- c. I should make a low-key statement to this effect in the House at the beginning of June and warn the Welsh local authority associations and individual local authorities as suggested in paragraph 8.

RNE

11 May 1981  
Welsh Office

METHOD OF HOLDBACK

Holdback would be effected in its initial stages in a manner identical to the close ending operation, ie by adjusting the rate poundage schedule but applying multipliers to provide protection to authorities who had made sufficient contribution to the overall volume reduction target. However no "unprotected" authorities would lose more grant through holdback than a proportion (common to all unprotected authorities) of its current expenditure excess however defined. The proportion used would be calculated by expressing the net volume excess as a percentage of the gross excess attributable to the unprotected authorities. (On the basis of present figures the factor applied to the excess of each authority in the unprotected category would be around 50%).

Applying this principle ensures that the grant loss faced by individual unprotected authorities would be directly proportional to their current expenditure excess. This approach directly links current spending performance to grant loss and is fairer and more likely to deliver the volume reduction sought and other methods of holdback. It also eliminates the problem of border line authorities which would arise in a "banding" method and the often significant miss match between grant loss and expenditure excess that arises in other options.

Defining individual volume targets

Individual authority current expenditure targets have not been set in Wales but if holdback were to be employed such targets would have to be issued. The Welsh local authority associations have stressed the unfairness of relating current expenditure performance solely to 78/79 outturn and have suggested that account should also be taken of authorities spending performance in relation to GREs. Consideration is being given to this matter and there is a possibility of linking the percentage reductions to be specified for each authority to its present (ie budgeted) performance in relation to spending at the threshold level; GRE plus 10%. Thus an authority spending exactly at the threshold would be assigned the aggregate spending reduction factor for Wales, ie 4.6% below 78/79 outturn. An authority whose total expenditure amounted for example to 90% of the threshold level would be expected to achieve reductions of approximately 4.1% ( $0.9\% \times 4.6\%$ ) with another at 120% of the threshold level, a reduction of 5.5% ( $1.2\% \times 4.6\%$ ). Such an approach has some presentational appeal while at the same time avoiding the implication that, for this year at least, GRE was a fully fledged target in its own right. Such a method would be advantageous for authorities spending below the threshold and bear hardest on authorities whose expenditure was above the threshold.

Legal Position

Legal advice is being sought on the application of various holdback methods. Early advice is that the use of multipliers to provide protection to authorities achieving volume targets is acceptable but this will require further consideration, as will the possibility of determining holdback in respect of authorities performance in relation to GRE as well as current expenditure.