

2  
PRIME MINISTER

2 July 1986

LOCAL GOVERNMENT FINANCE

A further progress report on discussions in E(LA).

Provision

E(LA) is moving towards a consensus on local authority finance next year, though the Treasury are still heroically standing out. The figures for provision now look like this:

|                    | £bn  |
|--------------------|------|
| 1986-87 Settlement | 22.3 |
| 1986-87 Budgets    | 24.2 |
| 1987-88 Proposal   | 25.2 |

is an increase of  
£2.9bn excluding  
anything extra for  
teachers' pay.

The proposed provision represents a cash increase of 3.75% on budgets for this year - no change in real terms. Given that we have little hope of getting Labour authorities to respond to our signals, putting any lower figure in the White Paper would be pretty futile and would just require a bigger hidden provision in the Reserve.

Aggregate Exchequer Grant (AEG)

This year's AEG was set at 46.4%. Viscount Whitelaw said at E(LA) that he couldn't find any overwhelming support for either increasing or decreasing it, so maybe it should be left where it is. But with provision rising so dramatically, AEG



would go up in absolute terms from £11.8bn this year to around £12.9bn next year.

This means a big increase in the tax-financed element of local expenditure. It might enable us to hold rate increases down to 5% or so. But it correspondingly reduces our room for manoeuvre on tax cuts. In the last resort, the Treasury would rather that rates went up than that tax cuts were jeopardised.

John MacGregor and Nicholas Ridley are now negotiating. You can expect the issue to come to you soon.

#### Abolition of Grant Recycling

Both Treasury and DoE are working on the assumption that we will legislate to abolish grant recycling, so that if grant is taken away from high-spending authorities it is not given back to low spenders. This opens up a gap between gross grant notionally set aside for local authorities, and the net grant we actually give them after claw-back. The DoE will only agree to abolish grant recycling if grant is generous enough to avoid a monster row with local authorities. The Treasury are banking on a low eventual net grant that will save them money. I am worried that the two departments are going into this exercise expecting different things out of it.

#### Rate-Capping

The other issue is rate-capping. E(LA) agreed a double test for rate-capping:



- i. authorities should be budgeting to spend more than 12.5% above GRE in 1986-87; and
- ii. have increased spending either by more than 4% since 1985-86, or (if rate-capped already) 20% since 1982-83.

This is tougher than the 14% above GRE originally proposed by Kenneth Baker. Twenty authorities are caught, as against twelve this year.

Significantly, Liverpool drops out of the list, as it is planning to spend 10.4% above GRE in 1986-87. Their budget is, of course, bogus as it includes large unspecified savings. Their underlying expenditure plans would take them into rate-capping. But if Liverpool is heading for another financial crisis, Ministers decided it was best to keep clear and let them stew in their own juice. As Liverpool may need a big unpopular rate increase to balance the books, the DoE do not want to be put in the touchy position of opposing it because of rate-capping. The Treasury accepted this.

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