

CONFIDENTIAL

PRIME MINISTER

LOCAL AUTHORITY FINANCE

This meeting has been arranged at the Chancellor's insistence. The Chancellor feels that you must have an opportunity to comment on the agreement reached between the Treasury and the Department of Environment about local authority expenditure and RSG before it is put for endorsement to E(LA).

There have been some difficult discussions this week. One story is that the Chief Secretary and Mr. Ridley reached an agreement which the Chancellor then sought to overrule. Mr. Ridley made a further concession, the Chancellor refused to agree to it, then agreed to it, then withdrew his agreement, and then restored his agreement. The other side of the story is that the discussions were held without Private Secretaries present, and Ministers later failed to agree on what had been agreed.

In any event, the Lord President is furious with the Chancellor. He feels that his authority in handling discussions about local authority finance has been questioned.

I said earlier I thought - partly in order to try to cool things down - that if the Lord President would prefer this, you would almost certainly say that you would wish to leave this to him to settle, and that you would stand by whatever he decided. However, the Lord President (probably rightly) felt that if the Chancellor wanted a meeting, he should be allowed to have it.

The upshot is that there is no disagreement about the substance among any of the people coming to your meeting, though the Chief Whip may not be familiar with the proposals. The Chancellor simply wants you to be aware of what is proposed. I suggest you have those present take you through the proposal, pointing out any pitfalls. It would be worth

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spending some time on the reception this package is likely to receive in both Houses of Parliament, bearing in mind the need for legislation to abolish close ending/recycling, and also to impose controls on gross capital expenditure (which seems to be the way the Department of the Environment and the Treasury are going).

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pp. DN

9 July, 1986.

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PRIME MINISTER

RATE SUPPORT GRANT SETTLEMENT 1987/88


1. You are meeting the Lord President of the Council, the Chancellor of the Exchequer, the Secretary of State for the Environment and the Chief Secretary, Treasury at 10.00 am on 10 July to discuss the Rate Support Grant (RSG) Settlement for 1987/88.

CONCLUSIONS

2. You will wish to make clear whether the agreement which has been reached between the Ministers present has your support. If you are content with the proposed RSG Settlement for 1987/88, the Lord President of the Council will commend it to E(LA) next week, with a view to an announcement in the week beginning 21 July.

BACKGROUND

Attached
3. The Lord President's minute of 9 July brings out the large increases over the White Paper figures that are now necessary. Both provision and Aggregate Exchequer Grant in the PES baselines for 1987/88 were simply rolled-on unchanged from the 1986/87 figures which, in turn, were set at virtually a cash freeze on 1985/86. The agreement set out in the Lord President's minute was reached today, and the Lord President does not believe that E(LA) would be able to come together on anything very different. We understand that the Chancellor of the Exchequer, while he agrees with the proposals, is anxious that you should personally have the chance to discuss such very substantial increases to public expenditure figures before any commitment is made in E(LA).



4. If these proposals are approved they will need to be announced, in the usual way, before the Summer Recess. One element in the proposals - the abolition of grant recycling - will need legislation early next Session. It is possible that legislation will also be needed then to impose new controls on local authority capital spending, but the Chief Secretary and the Environment Secretary are still preparing a paper on that for E(LA) to consider next week.

MAIN ISSUES

5. The main issue is whether the proposed RSG settlement strikes the right balance in, on the one hand, enabling responsible local authorities to have low rate increases while, on the other hand, maintaining grant pressures against overspending in a sustainable way. The increased provision and grant are balanced by heavier pressures from the abolition of grant recycling and the introduction of an 'unallocated margin', and the main points on all these aspects are set out below. An additional measure of increased firmness towards local government spending will be the increase in the number of rate capped authorities from the present 12 to 20. This also needs to be announced before the Summer Recess.

6. A note is attached illustrating the effect of the settlement proposals on the rates in different classes of local authorities. You will, however, know all the provisos that have to be attached to this kind of exercise. The rates will, of course, be crucially affected by authorities' actual spending decisions.

PROVISION

7. The proposed provision figure of £25.2 billion represents a real-terms freeze on authorities' budgets for 1986/87 (ie it is simply increased by the GDP deflator of 3.75%.) The proposed provision is £2.9 billion above the very low White Paper figures mentioned above but E(LA) would not accept anything lower as realistic. Neither this figure nor the proposed figure for grant includes anything extra for the conditional offer on teachers' pay (£1.25 billion overall, with some £200 million falling in 1987/88)

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if agreement is reached).

The eventual agreement may of course
be much more than the Government's
conditional offer.

AEG

8. The Lord President, and E(LA) generally, feel strongly that the percentage of relevant expenditure represented by AEG should not be reduced below its present level of 46.4%. (When the present government took office the figure was over 60%). The proposal now agreed by Treasury Ministers is for that percentage to be maintained unchanged. This gives a figure for grant at settlement of about £12.9 billion (about £1.1 billion above the White Paper).


I understand the figure now rounds
to £12.8 bn.

GRANT RECYCLING

9. At present the grant that is forfeited by overspending authorities is recycled to all authorities. This means that authorities benefit from other authorities' overspending (and can benefit from their own). The proposal is to abolish this, so that all authorities will see at the outset exactly how the block grant pressures will affect them. E(LA) have provisionally agreed to this, subject to realistic levels of provision and grant.

"UNALLOCATED MARGIN"

10. This device does not affect the overall provision figure, or the quantum of grant, but it reduces Grant Related Expenditures (GRES) so that authorities come up more quickly against the block grant slopes. There is a question, still to be decided, whether the proposed reduction of 5% should be made to the service lines of expenditure (which spending Ministers will not like) or only to the GRES. If E(LA) cannot agree to an "unallocated margin" the Treasury Ministers and the Environment Secretary will have to insist on steeper slopes. Of the two, the "unallocated margin" is rather more helpful for shire authorities.



RATE-CAPPING

11. E(LA) agreed that 20 authorities be rate-capped in 1987/88 as against 12 in 1986/87. There are to be 2 criteria for selection:-

a. authorities budgeting to spend more than 12.5% above GRE in 1986/87; and

b. authorities which have increased spending by more than 4% since 1985/86 or (in the case of previously selected authorities) by 20% since 1982/83.

To rate cap more than 20 would mean setting as a criterion for selection spending close to 10% above GRE. The Department of the Environment's strong legal advice was that this would be vulnerable to legal challenge, quite apart from the administrative burdens it would impose on DoE.

LOCAL AUTHORITY CAPITAL EXPENDITURE

12. The Secretary of State for the Environment and the Chief Secretary have separately been considering further reform of the system for controlling capital expenditure. You will recall that the present system is ineffective: outturn has consistently exceeded provision in recent years as local authorities make use of the spending power associated with accumulated receipts. This year there is the extra problem that the undertakings given in 1984 (with Treasury agreement) by the then Secretary of State for the Environment that the allocations to individual authorities for 1987/88 would be no less than 80% of their allocation for 1985/86 cannot be accommodated within existing public expenditure provision for 1987/88.

13. The Environment Secretary's preferred course is to introduce a new scheme to operate from April 1987, broadly on the lines set out in the Green Paper last January. The new system would control gross rather than net expenditure, and would side step the question of receipts. It would both deliver a far more effective means of control, and release the Government from the earlier undertaking. The Chief Secretary accepts that if legislation is



to go ahead, it should be on the basis which Mr Ridley favours, although he sees difficulty in legislating in time for next April while at the same time issuing allocations to local authorities on the new basis in advance of Royal Assent. He would therefore prefer the Government to resile from the earlier undertaking on the proviso made at the time that the undertaking would be suspended if the 1987/88 cash limit were to be reduced on account of underspending during 1986/87. The Law Officers are being consulted about whether present circumstances provide a justifiable basis for proceeding on this course.

14. The Environment Secretary will be bringing forward proposals to a meeting of E(LA) early next week. So far neither the Ministers responsible for individual local authority services nor the business managers have been consulted. In the meantime there is no need for any decisions to be taken.

HANDLING

15. You may wish to invite the Lord President to comment on the balance of the proposals he is putting forward, and to say how he judges they will be received by E(LA). Does he foresee problems with spending Ministers when E(LA) goes on to decide the service breakdown? The Chancellor of the Exchequer will wish to comment on the wider financial implications of the proposals to which he has agreed. The Environment Secretary, and the Chief Secretary, might be asked to comment particularly on their assessment of the effect on local authority spending, and on rate increases.

16. You may also wish to say that you note that proposals on local authority capital control are about to be made to E(LA) and that, while you will be glad to note any major points that the Ministers present want to register, you do not wish to be drawn into that topic until E(LA) have had a chance to discuss it.

A. J. L.

A J LANGDON

9 July 1986



1987/88 RSG SETTLEMENT:
CHANGES IN LOCAL CONTRIBUTIONS, ASSUMING
INCREASED EXPENDITURE OF 53/4% (ie GDP plus 2%)

ANNEX

	%
Shire areas	3.2
of which	
districts	14.6
counties	1.7
Metropolitan areas	4.3
Inner London	9.3
Outer London	9.0
England	4.9

Notes

1. These average figures assume provision set at 1986/7 budgets plus GDP (33/4%) with provision distributed between services in accordance with the reports of the Expenditure Groups. The grant percentage is 46.4%.
2. The figures quoted are changes in local contributions (that is rates plus drawings from balances).
3. All figures are subject to change in the light of final decisions on block grant mechanisms and GRE methodology.

LOCAL GOVERNMENT FINANCE

Viscount Whitelaw has steered E(LA) towards a reasonable deal.

Provision

The figures for provision (excluding anything extra for teachers) are:

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

The proposed provision is a cash increase of 3.75% on budgets for this year - no change in real terms. We have little hope of getting Labour authorities to respond to any signals, so 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)

AEG is to be set at 46.4%, the same as this year, up from £11.8bn this year to £12.8bn next year (actually £12.85bn, hence the confusion in the paper between £12.8bn and £12.9bn). This is the first cash increase in AEG for three years.

Subject to what comes out on teachers' pay.

This increase in the tax-financed element of local expenditure should enable us to hold rate increases down to 5% or so. But it correspondingly reduces our room for manoeuvre on tax cuts. The crucial ready reckoner is that £1bn of AEG is equal to about 7% on rates, or almost 1p off income tax.

Legislation to abolish Grant Recycling

Both Treasury and DoE want to legislate to abolish grant recycling. This is the trickiest part of the deal. It means that whilst gross grant is set at £12.9bn, some will be withheld from high spenders without being returned to the low spenders. So actual net grant could be, say, £12.5bn. The Treasury thereby retrieves some of the ground it conceded on AEG.

The new system is a clear theoretical improvement on grant recycling. As we found this year with Sefton, Bury and Wirral, recycling can be a pretty indiscriminate device, and comes too late to influence rate setting. Abolition increases grant pressures on the high-spenders.

But, especially if we are to have legislation on capital controls as well, it will mean that you have very controversial local government finance legislation in the next Session. If Labour authorities go ahead and increase their rates, they will try to pin the blame on the Government's draconian new régime. And everyone will have to work on the basis that we have abolished recycling, before legislation has

1 actually got through the House, even though there is a risk it will be mangled.

You will want to satisfy yourself that the politics of legislation has been properly thought through before agreeing to this part of the deal.

Rate-Capping

Twenty authorities are to be rate-capped, 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, whereas an of 12.5% or more gets rate-capped. Their budget is, of course, bogus as it includes large unspecified savings. Their underlying expenditure plans would take them into rate-capping. But it is probably best to keep clear and let them stew in their own juice, especially as Liverpool may need a big unpopular rate increase to balance the books.

Conclusion

The Treasury may not like a big increase in gross grant, but the DoE know that actual net grant may be rather lower. The proposed legislation to abolish grant recycling is going to be difficult to deliver.

David Willetts

DAVID WILLETTS

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FROM: A C S ALLAN
DATE: 9 JULY 1986

CHANCELLOR

cc Chief Secretary
Sir P Middleton
Mr F E R Butler
Mr Anson
Mr Jameson
Mr Scholar
Mr Turnbull
Mr Culpin
Mr Pirie
Mr Tyrie

RSG SETTLEMENT 1987-88

The information you asked for on recent changes in AEG is as follows:

AEG at Settlement in England

	AEG (£m cash)	Year-on-year increases			Grant Percentage
		£m	% cash	% real-terms	
1981-82	10895				59.1%
1982-83	11484	589	5%	-2%	56.1%
1983-84	11782	298	3%	-2%	52.8%
1984-85	11872	90	1%	-3%	51.9%
1985-86	11764	-108	-1%	-7%	48.7%
1986-87	11764	0	0%	-4%	46.4%
1987-88	12830	1066	9%	5%	46.4%

(note: comparisons with earlier years are difficult because Settlements then were based on volume plans, with AEG uplifted after the Settlement to allow for increases in prices; and Settlements were done for England and Wales together).

A C S Allan

A C S ALLAN

Mr Norgrove
No. 10

pa

MISS RUTTER

As requested

Jim Rutter
9/7

LA CAPITAL : FORWARD COMMITMENTS

I attach extracts from the letters sent out by the Department of the Environment at the end of 1984 and 1985 to each local authority. The letters informed the authorities about their level of allocations for Housing and "other services" for the following year.

R. N. Poffitt
9 July 1986.

Forward commitment on Housing allocations, December 1984

18. The Secretary of State announced on 26 September that he intended to discuss with the local authority associations ways in which the control of local authority capital expenditure could be improved. The review will take place early in 1985. It is not certain therefore that the present system will be operative beyond 1985/86. Authorities may assume, however, that if it is their HIP allocations for 1986/87 will be at least 70% of their initial allocations for 1984/85 (as notified in my letter of 24 November 1983), as previously promised, and that those for 1987/88 will be at least 80% of those for 1985/86 notified in this letter. This assurance is subject to the provisos that average rents in both years will rise in line with prices, that total housing receipts in both 1986/87 and 1987/88 will be at least £1530m and £1430m, and that the cash limit for each year in question is not reduced to offset overspending of a previous year's cash limit. The assurance does not apply to those authorities which it is proposed should be abolished under the Local Government Bill which is now before Parliament. The allocation procedure for 1986/87 and beyond will reflect the fact that some other authorities will have increased responsibilities as a result of abolition.

Forward commitment on Housing allocations, December 1985

23. The Secretary of State announced last year that he intended to discuss with the local authority associations ways in which the control of local authority capital expenditure could be improved. Following those discussions, the Government intends to publish proposals early in the New Year. In accordance with the assurance given in my letter of 20 December 1984 authorities may, however, assume that if the present system still applies beyond 1986/87 then the HIP allocations for 1987/88 will be at least 80% of those initially notified for 1985/86. This assurance is subject to the provisos given in my letter of 20 December 1984.

Forward commitment on "Other" allocations, December 1984

9. The Secretary of State announced on 26 September that he intended to discuss with the local authority associations ways in which the control of local authority capital expenditure could be improved. This review will take place early in 1985. It is not therefore certain that the present system will be operative beyond 1985/86. Authorities may assume, however, that if it is, then their basic Other Services block allocations for 1986/87 will be at least 70% of their 1984/85 allocations (as previously promised) and that those for 1987/88 will be at least 80% of those for 1985/86 notified in this letter. This assurance is subject to the provisos that the national level of receipts appears likely to be maintained at at least £370m per year, and that the cash limit for each year in question is not reduced to offset overspending of a previous year's cash limit. The assurance does not apply to those authorities which it is proposed should be abolished under the Local Government Bill which is now before Parliament. The allocation procedure for 1986/87 and beyond will reflect the fact that some other authorities will have increased responsibilities as a result of abolition.

