



PRIME MINISTER

As you know, E(LA) have been considering the main elements of the Rate Support Grant (RSG) settlement in England for 1987/88, which will need to be announced before the Summer Recess. This requires in practice an announcement in the week beginning 21 July.

2. We are all agreed that we need a more realistic settlement in 1987/88 than in 1986/87. For 1986/87 we set provision for local authority spending at close to a cash freeze on authorities' budgets for 1985/86; and we set Aggregate Exchequer Grant (AEG) at a cash freeze on its 1985/86 level. In the event, local authorities increased their current spending by around 8 per cent, resulting in an overspend of £2 billion and average rate rises of over 11 per cent.

3. For 1987/88 we set provision in the last Public Expenditure White Paper at the same cash figure as 1986/87. The agreed aim is to produce a settlement that will allow local authorities who budget responsibly to have low rate rises. But we are equally agreed that we must continue to use grant pressures to discourage local authorities from increasing spending sharply: local authority current spending amounts to a fifth of the planning total.

4. At the last E(LA) meeting the Chief Secretary reserved his position, but there was a general consensus among the rest of the Committee that we should set provision for 1987/88 at a real-terms freeze on local authorities' budgets for 1986/87 (ie a cash increase of 3.75 per cent, equal to the GDP deflator). This means increasing provision by £2.9 billion to £25.2 billion, excluding any extra provision in respect of the conditional offer on teachers' pay. (The increase is so large because of the way we set provision in the White Paper.) There was



also a consensus view - which I myself strongly endorse - that the grant 'percentage' (the level of AEG as a percentage of the settlement provision for relevant expenditure) should be held at its 1986/87 level of 46.4 per cent. This means increasing grant at settlement by £1.1 billion to £12.9 billion: in recent years we have been holding AEG constant in cash.

5. The Chief Secretary and the Secretary of State for the Environment have now agreed to commend these figures to E(LA) next week. They need to be seen alongside the decision already reached by E(LA), to increase the number of rate-capped authorities from 12 to 20, and the following two changes to sharpen block grant pressures on authorities' spending. First, the Local Government Bill early next Session would contain provisions to abolish the recycling of grant, so that authorities would know from the outset exactly how the grant discipline would affect them and would not benefit from overspending. Second, not all the provision should be allocated to service Grant Related Expenditures (GRES) but instead there should be an "unallocated margin" of 5 per cent. The other members of E(LA), who will be primarily concerned about the breakdown of provision for their services, have provisionally agreed to the abolition of grant recycling. The "unallocated margin", however, will be new to them and their agreement will need to be obtained. The alternative would be to steepen the slopes of the poundage schedule by 0.1 p.

6. E(LA) will also be asked next week to agree to a new system of capital controls.

7. I attach for convenience a note of the elements of the package which includes an allowance of £350 m in the calculations for the use of special funds. (This does not affect the AEG percentage mentioned above, but it does have a relatively small effect on the AEG quantum, which it reduces by about £70 m.)



Conclusion

8. I am pleased that the Chief Secretary and the Environment Secretary have been able to reach agreement on this package. It has my full support, and meets our objective of realism agreed last year. It would mean average rate rises, so I understand, of perhaps 5 per cent for responsible authorities. Given the importance of the issue, I should very much like to run over this with you and the colleagues most closely concerned before I commend it to E(LA) next week.

9. I am sending a copy of this minute to the Chancellor of the Exchequer, the Chief Secretary to the Treasury, and the Secretary of State for the Environment, and the Chief Whip, Commons, who should, I think, join us at our meeting. I am also sending a copy to Sir Robert Armstrong.

WOLW

Privy Council Office
9 July 1986

MAIN ELEMENTS OF RSG SETTLEMENT

Provision		£25.2 billion
AEG at settlement	about	£12.8 billion
AEG percentage	46.4	
"Unallocated margin"	5%	

Abolition of grant recycling in Local Government Bill next Session.

RATE LIMITATION

Increase in rate-capped authorities from 12 to 20.

CAPITAL

New regime, details under discussion.

