



CONFIDENTIAL

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PRIME MINISTER

THE NEW GRANT SYSTEM

[E(LF)(87)26 & 27]

DECISIONS

The Sub-Committee needs to decide on the main features of the new grant system which will start to replace the existing system in England and Wales in 1990/91. The most important issues are:-

- i. whether there should be two separate grants (needs grant and standard grant) or only one grant combining these two elements;
- ii. whether grant should be paid directly to each tier of authorities or only to the lower tier;
- iii. how much discretion the Government needs to retain over the distribution of grants.

The papers do not discuss how needs should be assessed under the new system (the subject of recent correspondence between the Chancellor and Mr Ridley). Mr Ridley promises a later paper on this.

BACKGROUND

2. One of the main features of the proposals in the Green Paper "Paying for Local Government" was a much simpler grant regime than at present. The introduction of the community charge and explicit sharing of national non-domestic rate (NNDR) income by pooling will give all authorities broadly the same resources. Grant will no longer have to be paid to achieve resource equalisation as at

present. Nor will grant need to vary with expenditure. The two remaining aims of the grant system will be to compensate for differences in needs and to provide a contribution from national taxpayers towards the cost of local services.

3. The Green Paper proposed a system comprising two separate grants to achieve these two aims:-

i. needs grant, which would be paid to bring each authority's remaining spending needs down to those of the authority with the lowest needs;

ii. standard grant, which would be paid to all authorities as a common per capita amount in each area, designed to reduce the community charge they would otherwise have to levy.

The new system was intended to be simpler and more stable than block grant. Accountability was also a major aim - since grant would not vary with expenditure, any spending above the level of assessed needs would be met in full by community charge payers.

MR RIDLEY'S PROPOSALS

4. Mr Ridley now proposes some changes -

i. to replace the separate needs and standard grants with a single revenue support grant. This would be calculated so that authorities in each area could spend at the level of their assessed needs by levying a common community charge. The change is more of presentation than substance;

ii. to pay grant (and the NNDR pool) notionally "at taxpayer level" rather than to each authority as in the Green Paper. The grant and NNDR contribution in support of services provided by both tiers of local authorities in each area would be paid to the district or borough council. County Councils would issue a community charge precept for their gross

expenditure. The district councils would combine this with ^{their} own gross expenditure, and then net off grant and NNDR money. Community charge payers would get a bill showing these calculations, along the lines set out in paragraph 5 of the Note attached to Mr Ridley's Memorandum. Mr Ridley believes that this approach will improve accountability.

5. Mr Walker's paper disagrees with the proposal to pay grant at taxpayer level. He believes that community charge payers should be able to relate the charge they pay directly to the spending of the district and county councils. He therefore wishes to continue to pay grant to both tiers of authorities in Wales.

6. Mr Ridley makes a number of other proposals about the detailed operation of the new grant system. The main ones are -

i. to remove the existing statutory concept of aggregate Exchequer grant (AEG), which is the total of rate support grants, specific grants and supplementary grants to local government;

ii. to specify the formulae for needs assessments in a separate Order from the annual RSG Report, which would not necessarily be changed every year;

iii. to have no arrangements to limit grant changes between years using safety nets or caps;

iv. a discretionary power to pay extra grant when special circumstances arise after the start of a year;

v. to keep a statutory requirement to consult local government, but at a minimum level.

MAIN ISSUES

7. It is important to note that Mr Ridley's proposals relate solely to the simple grant regime which will apply when the Green Paper system is fully in operation, and were predicated on the assumption that his proposals for an instant switch to the community charge would be accepted. Your decision at the last meeting of E(LF) to retain transitional arrangements of the sort proposed in the Green Paper implies very complex grant arrangements during the transition. You will wish to ensure that these are being worked up for inclusion in the Bill (if possible, they should be covered in the new paper requested from Mr Ridley on the transitional arrangements). The rest of this brief is concerned with the long term arrangements proposed in Mr Ridley's paper.

One Grant or Two

8. Mr Ridley's proposal to combine needs and standard grant into a single revenue support grant seems a presentational improvement. The 'Green' Paper sought to draw a distinction between the amount of grant provided by the Government to equalise needs, and the amount provided simply to reduce the level of local taxation. But no hard and fast distinction exists. As Mr Ridley points out, if the needs assessment of the minimum need authority goes down, the needs grant of every other authority will go up, and there will be less left to be paid as standard grant. But the combined grant entitlement of most authorities will hardly have changed. It makes sense to avoid confusing fluctuations between the two grants by combining them into a single revenue support grant. Against this it may make the new arrangements a bit more difficult to understand and therefore to present. But on balance you will probably want to agree with Mr Ridley.

Payment at Taxpayer Level

9. This is probably the most important issue the Sub-Committee

needs to decide, and it is the one on which Mr Ridley and Mr Walker are divided. It would be possible to adopt different approaches in England and Wales, but this would be decidedly odd. You will probably want to reach a common decision for both countries.

10. Mr Ridley's proposal to pay grant only to the lower tier has advantages -

i. it avoids the need to split grant between tiers, and therefore results in a simpler system (although Mr Ridley still proposes to assess needs for each authority individually);

ii. it makes the total benefit which each chargepayer receives from Exchequer grant and business rates more explicit;

iii. it avoids some technical quirks, such as the possibility of a few very low spending districts getting more in grant and NNDR income than they actually spend, and thus having a "negative" community charge (which in practice would simply mean they could set a charge below the level of the county "precept").

But there are also some disadvantages -

iv. unless they are very sophisticated, chargepayers will not be able to tell which tier is responsible for the particularly high or low charge in their area. A high county precept may reflect high needs or extravagance - it will be difficult to tell which;

v. it may not promote accountability as far as upper tier authorities are concerned. They will issue a gross precept. Councillors will not be asked to look at the net figure which will fall on chargepayers. A key feature of the system - that it is highly geared because all extra spending falls on the

community charge - will not be brought home to them;

vi. no grant is provided directly to authorities providing the major services of education, police, social services and transport throughout most of England and Wales. This may blunt the presentational advantages of providing extra grant - eg in support of police or teachers' pay.

11. It may help to put the arguments on accountability in terms of the figures in paragraph 5 of Mr Ridley's Note. Under his option, Gloucester County Council would levy a gross precept on Cheltenham of £536 per adult. Cheltenham's spending of £80 per adult would be added to get a total of £616 per adult. Subtracting grant of £204 and an NNDR contribution of £233 leaves a community charge of £179. But it is not clear how far accountability will bite on the county. If it spends 5% more, its gross precept will increase by just 5%. But the whole of the £27 per adult increase will be met by chargepayers, increasing their bills by 15% - it is not clear that the county will take the blame. Under the alternative system, grant would be paid to both tiers. The county would levy a net precept of perhaps £156 per adult (£536 less grant and NNDR of £380). If it increased its spending by 5%, its precept would have to rise by 17%, and the pressures of the new system would be very clear.

12. On their own, these arguments on accountability probably point in the direction of paying grant to both tiers as at present (and as is being done in Scotland). That will bring home to county councils - the largest class by far - the direct implications for chargepayers of their spending decisions. But you will want to decide whether the other advantages of Mr Ridley's proposals - simplicity and the greater visibility of the Government and business contribution to spending - outweigh the doubts on accountability.

Ability to influence the distribution of grant

13. The other key issue arises not out of any particular aspect of Mr Ridley's proposals but out of the whole package. His proposals will leave the Government with very few decisions to take each year. If, as he suggests, you change needs assessment methods infrequently, you will normally decide on only two figures - the total of "needs" and the total of grant to be made available. The distribution of grant would then be entirely automatic. The Government would have no levers of the sort it can currently use to produce an acceptable distribution - for example safety net and cap arrangements, and the distribution of the spending total between service GRES. This may have advantages: it could make the grant settlement less controversial and reduce opportunities for litigation. But it could also lead to results which are not ideal from a political point of view. You will want to decide whether this is acceptable.

14. On a more detailed level, the proposal to take no powers to limit grant changes between years seems rash. It is also strangely at odds with Mr Ridley's proposal to take a power to pay extra grant to compensate for changes in circumstances in mid-year. If changes in needs assessment methods are infrequent they are also likely to be bigger (when they occur) than under the present system. New data - particularly from a new Census - can also lead to sharp changes in grant. This suggests that if there are no powers to limit changes, community charges will sometimes have to change sharply in ways quite unconnected with spending changes. It might be prudent to take powers to mitigate grant changes, even if you use them more sparingly than under block grant.

VIEWS OF OTHER MINISTERS

15. Mr Walker's views are set out in his paper. I understand that the Chancellor and Chief Secretary are mainly concerned about issues related to specific grants. They favour the retention of the aggregate Exchequer grant (AEG) concept, at least within

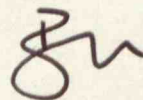
Government, because of the control it gives them over the total grant going to local authorities (under the present system, any increase in a specific grant automatically reduces the amount paid as block grant). Mr Ridley may accept this provided AEG is not enshrined again on the face of the legislation. They may also argue for specific grants to be shown on community charge bills as part of the Government contribution to spending. Other Ministers are likely to be concerned about the implications of the grant system for their services, and in particular whether needs assessments will continue to be calculated separately for each service. This is an issue for the later discussion on needs assessments.

TIMING

16. Final decisions are needed on these issues before the Recess, so that the Local Government Finance Bill can be drafted for introduction in the Autumn.

HANDLING

17. You will want to ask the Environment Secretary to introduce his paper. The Secretary of State for Wales will wish to speak to his paper. The Chancellor or the Chief Secretary, Treasury will wish to comment, and other Ministers will also wish to contribute.



J. B. UNWIN

Cabinet Office
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