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Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

PRIME MINISTER

I have been giving some thought to the way in which local authority expenditure is treated in our public expenditure planning and control systems. Our present arrangements treat local authority spending on all fours with that of central government and do not recognise that central government's responsibility for and control of local authority spending is indirect. The introduction of the community charge and of the national non-domestic rate provide a context in which to rethink the present definition of the public expenditure planning total and its relationship with our medium-term objectives for public spending. You may remember that I alluded to this when Willie Whitelaw and one or two others raised a similar point at the public expenditure Cabinet last week.

The attached paper sets out briefly the case for a new planning total which concentrates on the expenditure for which central government is directly responsible and which accordingly brings grant to local authorities more explicitly into our plans. This would not imply any change in our underlying objective of reducing general government expenditure (which would still include both central and local spending) as a proportion of GDP. And we would make it clear that the change did not carry any implication that the Government was drawing back from its wish to restrain the growth of local authority spending.

If you agree that the proposals should be pursued I shall put them to colleagues and set in hand the discussions which will be needed between departments.

Handwritten signature

We have powers to keep rules or community charge... we are interested in the 2012 expenditure.

A NEW PLANNING TOTAL

One of the characteristics of the way the Government in this country plans its expenditure is that it includes the spending of both central and local government in its planning total. Very few other industrial countries do this. For federal states such as Germany, the US or Canada this would be inappropriate; but even in other unitary states such as France or the Netherlands, the government makes direct plans only for central government expenditure.

2. There are understandable reasons why the Government makes and legislates for policies which may be implemented by either central or local government. Responsibility for education, roads and law and order is shared between the two. It is helpful in planning policy to draw together all the expenditure, irrespective of the level at which it is incurred.

3. The Government also has policies for the burden of taxation, and rates and the community charge are just as much taxes as VAT. Finally, the Government has policies for the role and scope for the public sector as against the private sector, and its share of total national output.

4. But while drawing all public sector spending together, either in aggregate or for individual departmental programmes, has a number of advantages, it also has disadvantages. Our present procedures lump together expenditure for which government has differing degrees of responsibility and thus blur the status of the various aggregates. If the planning total is exceeded, for example, it is not immediately clear whether responsibility for this lies with central or with local government.

5. A further disadvantage is that by counting the total expenditure of local authorities in the planning total, insufficient attention is paid to the grants which central government provide to local authorities (because they are transfers

between parts of the public sector they do not count in the consolidated spending of the two sectors). Yet grant is extremely important - it is a major influence on what local authorities spend and it represents money which central government has to raise in taxes.

6. The "Paying for Local Government" reforms provide both an opportunity and a justification for rethinking our system. One of the objectives is to increase local accountability, ie to make it clear to local electorates when local spending rises whose responsibility this is, so that they can draw the appropriate conclusions. The present arrangements do not do this.

7. We therefore see advantages in restructuring our planning of public spending on the following lines:

i. There would be no change in our underlying objectives for public spending in terms of general government expenditure (ie central plus local spending) as a proportion of GDP.

ii. But within general government expenditure, the planning total would become the sum of central government's own expenditure, the grants it provides to local authorities, the permitted level of local authority capital spending and the external finance of public corporations, plus a reserve.

iii. The current expenditure which local authorities at present finance for themselves through the rates, and in future from the community charge, would be outside the planning total but still within general government expenditure as debt interest is now. The attached table shows how the accounts would look.

8. The new planning total would have a number of advantages:

i. It would comprise those elements for which central government is directly responsible and it would exclude that spending which local authorities decide for themselves.

ii. It would contain the grants paid to local authorities. These would have to be planned for 3 years ahead and not just one as at present. This would not only give local authorities a better basis on which to plan their finances,

but would make it clearer to the local electorate who was responsible for increases in local taxation. It would also create a baseline against which next year's discussion about grant would take place. It would help stop grant being determined by previous years' overspending.

9. There is one danger in adopting such a system. It could be interpreted as a decision by central government to give up its attempt to influence locally financed spending and to cut the local authorities free. This can be avoided if the change is made in the proper context. The new Bill will:

- i. introduce central control over non-domestic rates;
- ii. increase pressures of accountability through the community charge.

To make the change in the context of these reforms will make it clear that the Government is still concerned about local authority spending. Continuing to express our objective in the MTFs in terms of general government expenditure (ie central and local) will also make it clear that the Government is still concerned about the level of taxation and borrowing for the whole public sector.

10. One possibility would be to introduce such a change in the 1988 Survey so that the 1988 Autumn Statement/1989 White Paper set out planning totals on the new basis. Announcing three-years' plans for grant in the autumn of 1988 would give local authorities a better basis on which to plan for the transition to community charge from April 1990. If, following discussions with departments, we were to go ahead on this timetable, we could announce our intentions in the January 1988 White Paper (though this itself would still be on the old basis). We are also planning to bring out more clearly the role of the different tiers of government in our presentation of the expenditure plans in this year's Autumn Statement and 1988 White Paper. This is a worthwhile improvement in its own right but it would also provide a helpful stepping stone to a larger change on the lines above.

A NEW PLANNING TOTAL AND GGE

	<u>£ billion</u>		
	1985-86	1986-87	1987-88
Central Govt's own expenditure	99.9	106.5	110.2
Central Govt grants to local authorities	20.2	21.7	23.1
Local authority capital expenditure*	3.8	4.1	4.2
Nationalised industries' EFLs	1.7	1.0	0.7
Other public corporations	0.9	0.8	1.0
Privatisation proceeds	-2.7	-4.8	-5.0
Reserve	-	-	3.0
NEW PLANNING TOTAL	123.9	129.3	137.2
Other local authority expenditure (including debt interest)	15.6	17.3	17.7
Central Govt debt interest	13.2	13.0	13.4
Accounting adjustments	5.8	4.8	4.9
GGE	158.5	164.4	173.2

* Subject to decisions about the new form of local authority capital control.

PRIME MINISTER

LOCAL AUTHORITY EXPENDITURE IN THE PLANNING TOTAL

The Chancellor in his minute below proposes to consult colleagues about - broadly speaking - taking local authority current expenditure out of the planning total and including grant to local authorities in its place.

This would have a number of advantages which are described in the Chancellor's minute. (There is one which is not, namely that such a change might help to make the reform of local authority finance more palatable to local authorities.)

The main risk is that it could be seen as signalling that the Government was now giving lower priority to controlling local authority expenditure.

The Chancellor argues that this danger would be averted through the introduction of the community charge and the national non-domestic rate.

You would want to be absolutely convinced that this was the case before agreeing to such change. There are also concerns, though smaller, that the Chancellor proposes that the change should take effect in April 1989, whereas the community charge does not come in until April 1990. There is a further risk that local authorities would feel they could raise spending in the years to 1990, even if thereafter the effect on the community charge of higher expenditure began to bite.

Finally, this is a genie which is at present in its bottle. If and when it gets out that the Government is considering such a change, it could build up a momentum of its own, even though it is not clear that for example Mr Baker, Mr Channon and Mr Moore, for the personal social services, would necessarily favour the change (because it would show up the spending "controlled" by their Departments as the fiction that

it is). Lord Whitelaw and Mr Ridley, on the other hand, are likely to favour the change, as will the local authorities themselves.

I recommend that you say:

I'm afraid this would be a signal that we were going up the back to contact local authorities expenditure not

(i) before agreeing to such a change you would need to be absolutely convinced that it would not lead to weaker control of local authority expenditure; in this context you fear the signal which might be given to local authorities in the years before the community charge came into operation and you note that the Chancellor intends the change to operate from April 1989 whereas the community charge does not come in until April 1990;

(ii) you wish to discuss this in September, but in the meanwhile, you are content for the Chancellor to talk very confidentially to Lord Whitelaw and Mr Ridley who may consult a very small number of senior officials;

(iii) you would not wish knowledge of the proposal at this stage to go any wider.

Agree?

D.R.N.

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30 July 1987