



cc BG
cc B/UP

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

PRIME MINISTER

A NEW PLANNING TOTAL

As we agreed, I have put to Nick Ridley the proposals for modifying the public expenditure planning total so as to distinguish between the central government's grants to local authorities and the expenditure they finance themselves. He welcomes the approach as being both consistent with and a reinforcement of the changes we are making to local government finance. I enclose a copy of our correspondence.

He does, however, urge that the change should be made in 1990 rather than 1989. This would mean that it coincided with the introduction of the community charge in England and Wales. If changes are also made to the regime for controlling local authority capital spending it would be possible to take account of this in the new planning total from the start rather than having to make a change in the second year. Having reflected further on this, I accept the force of his arguments. I propose, therefore, that we indicate our intentions publicly in next year's debate on the Public Expenditure White Paper, produce a paper for the Treasury and Civil Service Committee in the autumn, and that the 1989 Survey and RSG negotiations be the first on the new basis.

I would now like to put the proposals to colleagues and, provided there is no unexpected difficulty, set in hand work by officials. I should be grateful to know whether you are content that I should do so.

I am copying this minute to Nick Ridley.

A handwritten signature in dark ink, appearing to be 'N.L.' with a stylized flourish.

N.L.

16 October 1987



The Rt Hon Nigel Lawson MP
 Chancellor of the Exchequer
 HM Treasury
 Parliament Street
 SW1P 3AG

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|--------------|--|
| CH/EXCHEQUER | |
| REC. | 06 OCT 1987 |
| ACTION | MR TURNBULL |
| COPIES TO | CST |
| | MR FER BUTLER MR ANSON MR HANTON MRS B. BUTLER MR GIENE MR PRATT MR POTTER MR FELLGERT MR PERFECT MR G. WHITE MR TYKIE |

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 LONDON SW1P 3EB
 01-212 3434

My ref:

Your ref:

2 October 1987

BF H/10
prop.

Dear Nigel

A NEW PLANNING TOTAL FOR PUBLIC EXPENDITURE

Thank you for your letter of 21 September proposing a revised structure for the public expenditure planning total.

I very much welcome the approach you propose and agree that we should take the opportunity offered by the introduction of the new local government finance system to make a clear distinction in our planning between what is centrally and what is locally determined expenditure. Local government should welcome the setting of grant levels 3 years ahead and this should help us presentationally with the transitional arrangements. However, we will not find it an easy task to balance the need to give appropriate signals about restraint and to set realistic totals which we do not have to change significantly each year. In the new system we will be breaking the direct link between spending and grant, but will nevertheless have to bear in mind the consequences for local taxation of the grant totals we fix.

On timing, whilst I agree that the present system is unsatisfactory, I am sure the logical time to make a change is 1990. This would co-incide with the introduction of the community charge and the new capital control system. Until 1990 I am bound by the requirements of the Local Government Planning and Land Act 1980 to set Aggregate Exchequer Grant in relation to local government's relevant expenditure for the year in question. A three year plan for grant would cut across this. I would, however, favour announcing the proposed change in the 1988 White Paper.

Before then, and subject of course to colleagues' agreement in principle, our officials need to do a good deal of further work on presenting the change and on its details. I agree with you that the precise treatment of capital expenditure must await development of the new control system, but we need to agree a broad line. We also need to consider how to treat specific grants both capital, (including on loan charges), and revenue and the interaction of these with Revenue Support Grant. Finally, as a matter internal to Government, we will need to decide how to handle the local authority element of the annual public expenditure round. I suggest that our officials should meet to take these matters forward.

Lawson

Nick

NICHOLAS RIDLEY

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Ray

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

21 September 1987

The Rt Hon Nicholas Ridley MP
Secretary of State for the Environment
2 Marsham Street
LONDON SW1P 3EB

- cc* Chief Secretary
- Mr F E R Butler
- Mr Anson
- Mr Hawtin
- Mr Turnbull
- Mrs R Butler
- Mr Cieve
- Mr Pratt
- Mr Potter
- Mr Seliggett
- Mr Perfect
- Mr G C White
- Mr Tyrie

Alan Wick

A NEW PLANNING TOTAL FOR PUBLIC EXPENDITURE

From time to time there have been suggestions that we should restructure the public expenditure planning total so that it includes the grant central government pays to local authorities and excludes the expenditure local authorities finance from their own resources, rather than as at present including all local authority spending. This suggestion was made again at the July Cabinet meeting on public expenditure, and as I indicated it is a subject to which I have been giving some thought.

The danger we have faced hitherto in making such a change is that it would inevitably be interpreted as a weakening on the Government's determination to restrain the growth of local authority spending. However, the introduction of the community charge and the national non-domestic rate provide an obvious opportunity to re-examine the present definition of the planning total and its relationship with our objectives for public spending.

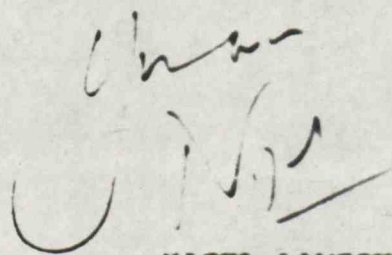
... The attached paper discusses the case for making the change in that context. This would not imply any change in our underlying objective of reducing general government expenditure (which will continue to include local as well as central government spending) as a proportion of GDP. And inclusion of forward plans for grant in the planning total will help us break away from the framework in which we are always reacting to whatever level of spending local authorities decide upon.



Before seeking the Prime Minister's agreement to putting these ideas to colleagues I would welcome your reactions. In particular, we need to consider how to organise the setting of plans for grant for three years rather than one; and the treatment of local authority capital spending. The paper assumes that the latter is within the planning total because the level of local authority capital spending is set by Government, and the aggregate used is their net spending because that is how the limit is defined. If we were to adopt a different basis for controlling their capital spending (eg by acting on borrowing) we would clearly need to think how that should be handled.

On timing, the paper suggests that the change could be made either in 1989, or in 1990 to coincide with the introduction of the community charge and the national non-domestic rate. A 1990 start would allow a new basis of control of capital spending/borrowing to be incorporated. But there are also arguments for pressing ahead and introducing the change in 1989. The present system is unsatisfactory and the sooner we can get away from it the better; and of course Scotland will move to the community charge in 1989.

If we are to keep open the option of the earlier timetable we need to press ahead quickly. I would welcome your views on both the proposal itself and the timing of its introduction.


NIGEL LANSON

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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 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 national output.

4. 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.

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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 see advantage in restructuring our planning of public spending on the following lines:

i. There would be no change to 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 finance for themselves through the rates, and in future from the community charge, would be outside the planning total but still within GGE 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. increase 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. The change could be introduced either in 1989 or 1990. Under the former it would be introduced 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 basis on which to plan for the transition to community charge from April 1990. The latter would, however, coincide with introduction of the community charge and the national non-domestic rate and would also allow the new planning total to reflect whatever is decided on control of capital spending/borrowing.

11. If, following discussions with departments, we were to go ahead we could, on either timetable, 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.