RA

MR GRAY

P 03480

PRG 22/6

REVENUE SUPPORT GRANT SETTLEMENT 1990/91

I attach a brief for tomorrow's meeting of E(LF).

2. The Prime Minister may also wish to know the latest position on the ideas which we discussed with the Chief Secretary on Monday.

3. The Treasury have now devised an option which would improve the position of the 27 local authorities with the lowest rateable values. This would include areas such as Pendle, Rosendale, Hyndburn, Calderdale and York. The Chief Secretary says that the targeting, although not perfect, is not bad. These authorities would be protected from any increase in community charge in 1990-91, on the assumption that the general safety net would allow losses of up to £25 per adult to feed through in other areas.

4. This new device could take the form either of a modification to the general safety net or of a new specific grant. The latter would require legislation but the Chief Secretary considers that this would not necessarily be a disadvantage since it would enable them to make sure that it was proof against judicial review.

5. Whichever approach was adopted, it would be financed by new money over and above the £23 billion agreed for AEF. The Chief Secretary expects the cost probably to be around £75 million per annum. In addition he would envisage putting another £25 million per annum into the new specific grant for education in inner London, making a total of new money of around £100 million per

annum. It would of course be possible to put more money into the approach if this is what Ministers wanted.

7. One aspect for decision would be the length of time for which the protection would last. The Chief Secretary believes that it could not be withdrawn after one year: there would probably need to be a period of, say, three years in which the authorities in question had a chance to adjust before the process of transition to the full community charge took place.

7. The Chief Secretary is anxious that none of this should be referred to at tomorrow's meeting of E(LF) and that the discussion then should be entirely on the basis that the safety net will be self-financing. Mr Ridley is not at present aware of the proposal. The work has been confined to a small group in the Treasury.

8. The Chief Secretary suggested that the next step might be a private meeting with the Prime Minister, the Chancellor, Mr Ridley, perhaps Mr Parkinson and himself to agree the proposal and the amount of money to be allocated to it. He would then come back to E(LF) on 6 July and put it formally to colleagues.

RTJW.

R T J WILSON
21 June 1989

PRIME MINISTER

P 03478

REVENUE SUPPORT GRANT SETTLEMENT 1990-91
[E(LF)(89)2, 3 & 4]

DECISIONS

Mr Ridley has now circulated two papers. The first, which you have already seen, sets out the package on the grant settlement for 1990-91 which he has agreed with the Chief Secretary, together with some ideas for revising the safety net. The second, which is a new paper, sets out some further ideas on the safety net. In addition there is a paper by Mr Baker which adds up what each main service Department thinks local authorities will need to spend in 1990-91.

2. You may wish to divide the discussion into two parts:

i. **the grant settlement**. A formal decision is needed that Mr Ridley should announce in July that the total of standard spending (TSS) for 1990-91 will be set at £32.8 billion and that Aggregate Exchequer Finance (AEF) will be £23 billion. The main service Ministers can be expected to argue for a much higher level of standard spending, reflecting what they believe will need to be spent on their services;

ii. **the safety net and the specific grant for education in Inner London**. You do not need to take decisions on these issues at this meeting. You may wish instead to have a general discussion of what the objectives should be and the relative merits of the options and then invite Mr Ridley to do further work.

3. A further meeting of E(LF) has been fixed for Thursday 6 July. This could be used to carry forward the discussion about the safety net and any other outstanding issues.

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BACKGROUND

4. Mr Ridley's first paper (E(LF)(89)3) sets out the outcome of the 1989-90 settlement. Despite a generous settlement last year local authorities have budgeted to increase their current expenditure by 9.1% compared to 1988-89. The resulting spending figures are 4.1% or £1200m above the level for which the Government provided in the settlement for the current year.

MAIN ISSUES

Mr Ridley's proposals

5. Mr Ridley's proposals are:

i. total standard spending of £32.8bn. This accepts 1989-90 budgets as the starting point but allows an increase of only 3.3% in current expenditure, a squeeze of at least 0.7% or £200m in real terms. But the increase over the total of GREs for 1989-90 would be about 10.5%. This should ensure that most authorities which have budgeted to spend at or below GRE this year could spend at or below their standard spending assesment in 1990/91;

ii. Aggregate Exchequer Finance of £23.0bn, an increase of £1.6 billion or 7.5% over 1989-90. £1 billion of this will come from the automatic growth in the NNDR. Exchequer grants will rise by 5% or £0.6bn.

The Chief Secretary will take the line that his initial inclination was to go for a tighter settlement; that he is prepared to agree Mr Ridley's proposals in the interests of reaching agrement; but that it is an absolute maximum beyond which he is not prepared to go. **Neither he nor Mr Ridley will refer to any of the discussions which have taken place.**

6. **This package would mean a community charge for standard spending of £275,** about the same as average actual rates per

f 275

1½m

£1½bn 8%

£32.8

adult in 1989-90. Mr Ridley believes that authorities may actually spend around £33.9bn, a 7% increase on 1989-90. This would mean average actual charges of £301 which would add about 0.4 percent to the RPI in April 1990 (about the same amount as was added to the RPI by this year's rate increases).

Service Departments' estimates of "need"

7. Mr Baker's paper covers an assessment by each service Department of what they believe authorities will "need" to spend in 1990-91. These assessments take 1989-90 budgets as the starting point, add 4% (£1.194bn) for inflation at the estimated level of the GDP deflator, £247m for demographic and other pressures, £589m for "additional burdens" and £843m for other cost factors (mainly higher pay settlements), and deduct £266m for efficiency savings. The resulting figure for total standard spending is £34.4bn, £1.6bn above Mr Ridley's proposal and £500m above his estimate of what local authorities may actually spend. It would represent an 8.5% (£2.7bn) increase on 1989-90 budgets, and implies that standard spending assesments would on average be about 16% above 1989-90 GREs.

8. It is not clear whether all the service Ministers will in fact argue for total standard spending at this very high level. But they can be expected to back a substantially higher figure than Mr Ridley proposes, using the following arguments:

i. that it is only realistic to start from budgets, and to recognise the additional pressures imposed by new Government policies and pay settlements endorsed or influenced by the Government (eg for the police and teachers);

ii. that the new system will have credibility only if standard spending assessments are at a level which responsible authorities will feel meets the pressures they face;

iii. that realistic and credible standard spending assessments will be necessary for their services if they are to persuade authorities to expand and develop their services in line with Government policies on <u>education</u>, <u>community care</u>, <u>highways</u> and <u>law and order</u>.

9. In introducing his proposals Mr Ridley will probably make the point that they are not an opening position in a negotiation but a firm set of proposals which he wishes to announce. **<u>You may wish to underline this point and draw on the following arguments</u>**:

i. Mr Baker's bottom-up approach would <u>validate</u> 1989-90 budgets, including the £1.2 billion overspend compared with the settlement;

ii. standard spending assessments would increase by 16% compared to 1989-90 GREs. This would give entirely the <u>wrong signal</u> to authorities about the Government's policy for public expenditure. Responsible authorities who aim to spend at or below GRE/SSA would see it as a green light for a large increase in expenditure;

iii. it would <u>encourage authorities to expand provision</u> in the areas where service Ministers exhort them to do so without seeking offsetting savings elsewhere in their budgets;

iv. with £23 billion of AEF, the <u>community charge for spending at need would be £317</u>. The service Ministers may argue for higher AEF to finance the spending which they believe to be necessary. This would reduce the CCSS, but might lead to even higher spending.

10. <u>You may wish to steer the Sub-Committee towards accepting the package agreed between Mr Ridley and Mr Major</u>, making sure

Edn & Health - (Bystanders in Govt Charge)

Transport Sec

Environment Sec

Chanc.

Chief Sec

Home Sec.

Lord Pres

Emp. Sec.

D.SS

Health Sec

Home Sec

Edn Sec

Welsh Sec.

They should all support the package. RRCG 21/6

that Ministers without a major service interest have a chance to contribute to the discussion: for instance, the Secretaries of State for Employment, Energy and the Lord President.

THE SAFETY NET

11. All Mr Ridley's options on the safety net are on self-financing: that is, the cost of protecting some authorities from losses would be met by reducing the gains of other authorities. **For the purposes of this discussion you may wish to endorse this approach**. [NOT TO BE READ OUT: Mr Major is working separately on additional proposals which would involve extra Exchequer finance. But he would wish to agree the details separately with you, the Chancellor and Mr Ridley before disclosing the proposal at the next meeting of E(LF). He hopes very much therefore that no reference to the possibility will be made at this meeting.]

NB

12. The purpose of the safety net is to limit changes in the average domestic tax bill as between different local authority areas. The Government's publicly stated position is that the safety net will prevent all changes in average bills in real terms as between 1989-90 and 1990-91, except that no area will be expected to pay more than £75 per adult to the safety net (that is, gains about £75 will be allowed to feed through). The Government has also said that the safety net will be phased out over 4 years. The legislation provides that there will be one- and only one - transitional report, which will need to set out all the details of the safety net for 1990/91 and subsequent years including its distributional impact.

13. Mr Ridley's second paper (E(LF)(89)4) sets out 6 options for the safety net. Their effects on community charges in each area for total spending at the level of TSS are shown in table 4 attached to that paper:

i. column 3 shows the present safety net. There is full protection for losers, financed by preventing all gains up to £74 per adult from coming through: in other words the small gainers pay for the protection for losers;

ii. column 4 shows a variant of the present net under which losses of up to £25 per adult are allowed. This reduces the contribution from gainers to a maximum of £39 per adult;

iii. column 5 also allows losses of up to £25. But this is financed by the largest gainers: gains up to £25 feed through, but larger gainers keep only 16% of their gains over £25;

iv. column 6 prevents all losses. This protection is financed by reducing all gains by 81%. Gainers keep only 19% of their gains;

v. column 7 is similar, but allows £25 of losses to feed through. Gainers contribute 57% of their gains to finance protection from losses above this level and keep 43% of their gains;

vi. column 8 allows losses up to £26 to come through. All other areas, losers well as gainers, pay a flat rate contribution of up to £26 to finance this protection.

14. Mr Ridley now prefers the column 8 approach: protection for losses over £26 per adult, financed by a flat rate contribution of up to £26 per adult from all other areas. He argues that this would be simple to understand and present, and that it would avoid the problem of large contributions from areas with high gains, like Westminster, Kensington and most of Buckinghamshire.

15. Mr Ridley also proposes a new specific grant of £100m in 1990-91 (financed from within AEF, and to be phased out in subsequent years) for education costs in inner London. The aim

would be to help the boroughs to meet ILEA's overspending in the transitional period before they can make savings. He proposes that this grant should be paid after the safety net. Since the grant would exceed the £26 per adult of losses which would be allowed to feed through, this proposal would turn all the inner boroughs into gainers in 1990-91 irrespective of their long-term position.

16. The decision between the various options for the safety net will depend on what you want the safety net to achieve. In particular:

i. the basis on which the safety net should operate. All the present options are based on a comparison between average rate bills per adult in 1989-90 (plus 4%) and the 1990-91 community charge. The alternative would be to limit the highest community charges in absolute terms. This is the approach which was adopted in Scotland this year. The logic is that the average rate bill under the old system is irrelevant to many people, eg people who pay no rates: a first-time payer in highly rated Buckinghamshire may find it as hard to meet a high charge as one in low-rated Lancashire. Do you want Mr Ridley at least to explore alternative options on the Scottish model?

ii. the right limit on losses. Another question is whether it is right to prevent all losses feeding through (as under columns 3 and 6) or whether it would be acceptable for some losses to take effect in 1990-91 (as under columns 4, 5, 7 and 8);

iii. how should protection for losers be financed? The options include removing all gains up to a certain limit (columns 3 and 4), removing a common percentage of gains, perhaps above some limit (columns 5, 6 and 7), and a flat rate contribution from all gainers (and losers up to eg £26 per head) (column 8);

iv. what is acceptable for the highest gainers (eg Westminster, Kensington, much of Buckinghamshire)? At present they are expecting to pay no more than £75 per adult to the net: indeed they are campaigning against paying even at that level. Only columns 3, 4 and 8 would limit their losses at or below this figure. The other options involve losses of up to £165 for Westminster;

v. what do you wish to achieve in inner London? Mr Ridley's proposed specific grant, paid after safety net protection, would turn all the inner boroughs into gainers despite the fact that 7 out of 12 will be losers in the long run (even if they get education spending down to the SSA level). For example, the average tax bill in Greenwich would fall from £285 in 1989/90 to £221-247 in 1990/91, although in the long run it is expected to rise to £579. This seems perverse: it could be avoided by paying specific grant before the safety net is calculated. You might want to ask Mr Ridley to look again at the interaction between his proposed specific grant and the safety net.

17. You will probably want to conclude the discussion by inviting Mr Ridley to bring forward a smaller range of options for the next meeting on 6 July.

HANDLING

18. You may wish to begin by asking for agreement to the grant settlement which is to be announced in July. You could ask the Secretary of State for the Environment to introduce his paper. You might then alternate the main service Ministers (the Secretaries of State for Education, Transport and Health, and the Home Secretary) with other Ministers without a service interest: in particular, the Chancellor, the Chief Secretary, Treasury, the Secretary of State for Employment, the Lord President, the

<u>Secretary of State for Energy</u>, the <u>Secretary of State for Social Security</u> and <u>other members</u> of the Sub-Committee.

19. You will then want a general discussion of the transitional arrangements, starting with the <u>Secretary of State for the Environment</u> and the <u>Chief Secretary, Treasury</u> before inviting other contributions. The <u>Secretary of State for Education</u> will wish to comment on the proposed specific grant for education in inner London (which he should welcome).

RJW.

R T J WILSON
21 June 1989