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Andrew Turnbull Esq.
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Your reference

Our reference

Date 16.xi.83

Dear Andrew,

Robert Culpin asked me to let you have a copy of the brief he has given the Chief Secretary for today's meeting with the Prime Minister on local authority finance.

Yours,

Jill Rutter

C O N F I D E N T I A L

FROM: [illegible]
DATE: 15 November [illegible]

CHIEF SECRETARY

cc Chancellor
Mr Bailey
Mr Wilding
Miss Kelley
Mr Pestell
Mr Scholar
Mr Watson
Miss Rutter
Mr Short

GRANT AND HOLDBACK FOR LOCAL AUTHORITIES IN 1984-85

The Prime Minister is chairing a meeting tomorrow with you, Mr Jenkin, Mr Gummer and Mr Wakeham. Your main arguments are in your letter of 11 November to Mr Jenkin:-

a. There is no need to relax the settlement.

b. Give an inch and the local authorities will take a mile.

c. If it is politically desirable to help Tory authorities, there are better ways of doing it than relaxing holdback.

<u>How to help Tories without relaxing holdback</u>

2. Relaxing holdback would confer the largest benefit on the largest overspenders: the cumulative reduction in holdback would be greatest for those overspending by 3% or more. That is a bad way of helping Tories.

3. What matters to them is the prospect for rates. That depends not only on targets and holdback but also on GREs. These determine the distribution of grant before holdback.

4. The GREs for individual authorities have not yet been announced. So we can vary them without seeming to cave in to pressure. Mr Jenkin has himself suggested a change, but has not brought out its significance.

5. When E(LA) agreed on holdback of 2-4-8-9-9, it was exemplified on the basis of this year's distribution of GREs. On that basis,

the DOE thought it implied average rate rises in the shire counties (not all Tory) of about 5.8% for spending at 3% above this year's targets. (This is at the top of the second page of your letter.) Ministers accepted that prospect.

6. Mr Jenkin has subsequently suggested some GRE changes in E(LA)(83). His paper on holdback - E(LA)(83)8-assumes those changes to be agreed.

7. On this revised basis, the agreed holdback of 2-4-8-9-9 implies average rate rises in the shires not of 5.8% but of 4.2% for the same change in spending. In other words, Mr Jenkin has found a way of reducing rate rises in the shires by 1½% since Ministers agreed holdback. The prospect for them is better than we thought, not worse.

8. Moral: we can help the shires without changing any of the announced features of the grant settlement. There is therefore no case for a general relaxation. If need be, we might be able to make further distributional changes, though these are never easy. This must be a better way of helping Tories than splashing money all round the country.

9. I stress this because the Prime Minister appears attracted by the idea of tilting the distribution (Miss O'Mara's minute of 10 November). You could support her.

10. Final point on this: Mr Jenkin also has some proposals for increasing targets by about £20 million - his letter of 20 October. You have not yet agreed, but I have advised you to be sympathetic if he will withdraw on holdback. The details are not important. What matters - again - is that you could benefit a lot of Conservative authorities much more cheaply by this means than by relaxing holdback.

Who is being responsible?

11. You have to take head on the claim that Tory councils are being eminently responsible, and the government is not. The defence of the settlement is on the second page of your letter. I think point c. is especially strong.

12. As to the virtue of local authorities, the best defence is attack. The attached table shows that most Tory shires have increased their

spending in real terms, and face only modest rate rises if they increase their spending next year by 5% or so.

13. Suffolk is a case in point - Mr Gummer's area. So far from having cut its spending to the bone, it has increased it since 1978-79 by about 6% in cost terms. (That is, Suffolk's spending has gone up roughly 6% more than prices.)

14. If next year Suffolk spends about 3% more than its budget for this year, rates need only rise by a bit less than 4%. As the DOE keep saying, that is a highly speculative estimate, and the actual figure could be lower.

15. If Suffolk spends more, then - true - it will face larger rate rises. But that is the point of a deterrent. We are not trying to induce large rate rises. We are trying to use the threat of them to deter high spending.

16. Caution: there are always hard cases. Some we can explain. Some we might be able to tinker with, if need be, by adjusting GREs. Whatever their individual merits, the crucial point is that a few hard cases cannot justify a general relaxation.

<u>To dither or stand firm</u>

17. If the government cannot keep its nerve with a large majority and no election in sight, there is little chance of getting a grip on local authority spending. One concession would increase the pressure for more.

18. I understand Mr Wakeham's view is that the government can probably sell the RSG settlement if it stands firm and shows that it means business. But if Ministers waver, they will be in trouble. You could support him.

<u>A "GRE exemption"?</u>

19. The main danger, frankly, is that the Prime Minister may suggest that it would be possible to buy off trouble by exempting from holdback authorities which spend more than their targets but less than their GREs. This would be fatal.

20. Instead of being allowed to spend without penalty up to the targets which have been announced, local authorities would be allowed to spend without penalty the higher of target or GRE. On preliminary estimates, the higher of the two would be at least £½ billion more than the total of targets. You would thus be endorsing another £½ billion of spending.

21. Put another way, even if all local authorities were to meet the government's guidelines and spend no more than target or GRE, whichever is higher, and there were thus no "overspending", local authority current spending would not be the £20.3 billion for which you have agreed to provide but about £20.8 billion. In principle, you would have to raise the public expenditure provision accordingly.

22. The yield of holdback would also be drastically reduced, perhaps by about £¼ billion. So grant after holdback would be much higher. The Chancellor would have to find the extra from taxes.

23. Mr Jenkin might say that responsible authorities would not spend all the way up to their GREs. That may be. But they would certainly increase their spending by some amount. Otherwise there would be no point in the concession.

24. The largest beneficiaries would probably not be Tory councils but Derbyshire (Labour) and Berkshire (no overall control). Again, this would be an inefficient way of helping friends.

25. Finally, it would be seen as an odd step backwards. As you know, there was a "GRE exemption" in 1982-83, and it was frankly disastrous. It was one reason why the targets for that year were so massively overshot. There has been no such exemption in 1983-84 and, although the targets have still been overshot, the excess has been less. To reintroduce an exemption in 1984-85 would be a major volte face.

26. As I have said before, there could have been a case earlier for distributing the agreed provision in such a way that the targets converged more on GREs. But that is water under the bridge. To grant a GRE exemption at this late stage could only be extremely damaging.

<u>Consultation with local authorities</u>

27. In case Mr Jenkin runs the argument that he has only consulted the local authorities, and not announced firm decisions, you might

like to be reminded of two points. First, the Lord President's minute to the Prime Minister of 18 October said "the holdback tariff... will be 2-4-8-9-9".

28. Second, Mr Jenkin was offered the option of "consulting" on three alternatives for holdback, as last year, but chose to present only one scheme. If the local authorities had not denounced it, we should have been amazed. Indeed, we should have worried that we had failed to make holdback painful enough to deter high spending.

RC

ROBERT CULPIN

1,00,020 → 3i.

1,00,000 → 3i

↗ GRE.

19.7

20.5

20.3

SPENDING RECORD AND PROSPECTIVE RATE RISES

	Real growth in current expenditure		1984-85 increases in local poundage contributions *	
	1978-79 to 1983-84	1981-82 to 1983-84	83-84 budgets +3%	83-84 budgets +5%
Buckinghamshire	+13.5	+6.0	-3.7	+ 5.3
Cambridgeshire	+ 7.8	+1.7	-1.4	+ 5.6
Devon	+ 4.0	+2.9	-0.1	+ 6.8
E.Sussex[1]	- 3.5	-1.6	+2.3	+ 9.3
Essex[1]	+ 6.1	+3.8	+2.4	+ 9.5
Hampshire[1]	- 0.7	+0.3	+1.9	+ 9.5
Kent	+ 0.9	-0.1	+0.8	+ 8.1
Somerset[2]	+ 3.9	+2.9	+5.4	+19.1
Suffolk[3]	+ 5.9	+3.2	+3.9	+12.5
Surrey[4]	- 1.6	+0.5	+2.8	+10.8
W.Sussex	+ 4.2	+2.2	-1.2	+ 5.9

* 2, 4, 8, 9, 9 holdback; preferred GRE package.

1. High <u>percentage</u> increases because rates low to start with. E Sussex losing some grant because previously too high on objective indicators.

2. In 1983-84 2% above target, 3½% above GRE.

3. In 1983-84 ½% above target, large increase in spending since 1978-79.

4. In 1983-84 2% above target.

BANK OF ENGLAND

With the Governor's Compliments

Speech given by

ROBIN LEIGH-PEMBERTON ESQ,
GOVERNOR OF THE BANK OF ENGLAND

at the Chartered Institute of Public Finance
and Accountancy Conference
'Local Government - The Post Election Scene'
on Wednesday 16 November 1983

SUMMARY OF MAIN POINTS

The Governor first reviews the progress that has been achieved since the introduction of the Medium-Term Financial Strategy in 1980. Although the detail of the strategy has been modified - and its objectives not always achieved - inflation has fallen faster than almost anyone predicted and the economy is looking more healthy than for some time (Paragraphs 3-7).

The PSBR has been substantially reduced, but the pressure for higher public spending is always present and considerable restraint will continue to be necessary. The targetted monetary aggregates remain at or somewhat above the top end of the target range, leaving no room for complacency - not least because monetary control is not an exact science (Paragraphs 8 and 9). To achieve balanced, sustainable growth, the long-running tide of increasing public spending will have to be arrested (Paragraphs 11-15).

From the above, the Governor draws four implications for <u>public spending</u>, with particular reference to local authorities:

- restraint in all parts of the public sector will be necessary (Paragraph 17);

- it is not clear that the right balance between capital and current spending has been achieved (Paragraph 18);

- accurate and speedy information is needed on public sector spending and receipts, and figures for local authorities are particularly slow and incomplete (Paragraphs 19 and 20);

- local authorities must remember the importance of rates in industrial costs; the rate burden <u>is</u> substantial for many businesses, and it is a burden over which they have little control (Paragraphs 21-23).

The Governor then turns to some encouraging trends in <u>local authority borrowing</u>, including the greatly reduced borrowing requirements of the last two years and lengthening of the average maturity of the debt (Paragraphs 24 and 25). There has also been a marked shift, actively promoted by the Government, in the sources of borrowing, away from the banking system and towards the Public Works Loan Board. The terms on PWLB variable rate facilities have become a "best buy" and PWLB quotas have been substantially increased. These changes have cut local authorities' borrowing costs, and at the same time helped the operation of monetary policy. It remains desirable that local authorities should continue to use the PWLB facilities fully (Paragraphs 27-31).

1 Mr Chairman, I was very pleased to be invited to speak at this conference today, as indeed was my predecessor, Lord Richardson, on a similar occasion in 1976. The Bank of England values its contacts with your institute, which has a deserved reputation for encouraging debate on matters of importance to your members. The subject of this conference is certainly of importance, for local government is currently at one of the more important junctures of its recent history.

2 As Governor of the Bank of England, my contribution to today's proceedings is to sketch the financial environment in which local authorities are likely to operate in the next few years. As an active member of Kent County Council for fifteen years and its Chairman for three, I hope to present this sketch in a way that will reflect an awareness of your problems.

3 The main objectives of Government economic policy over the last four and a half years have been constant: these are to reduce the rate of inflation and to secure a lasting improvement in the performance of the UK economy, so providing the foundation for sustainable growth in output and employment. The need to curb inflationary expectations has been - and continues to be - vital. The uncertainty caused by high and variable inflation discourages long-term investment by both the public and private sectors. If this uncertainty is not greatly reduced, we shall not have lasting prosperity.

4 The strategy for curbing inflationary expectations has also remained constant. The Medium-Term Financial Strategy was introduced in March 1980 and it has subsequently set out each year the monetary targets which seemed appropriate for the maintenance of downward pressure on inflation. It has also set out the way in which the Government intends to operate fiscal policy so as to reduce public sector borrowing as a proportion of the nation's Gross Domestic Product. The figures in the Medium-Term Financial Strategy have not remained engraved in stone from year to year: indeed, in the operation of monetary policy we now consider, and set targets for, a variety of aggregates, whereas there was initially an objective for only one such aggregate. Nor have the objectives always been achieved. But the thrust of policy from year to year has been the same; and as the Chancellor said a month ago in his Mansion House speech, the Medium-Term Financial Strategy is "alive and well".

5 Much has been achieved in this 3½ years. In particular, inflation has fallen faster than almost anyone had predicted. This success was somewhat overstated by the Retail Price Index earlier this year, when the year on year rate of increase fell to under 4%, influenced by a number of erratically favourable factors; and by September, the annual rate of price increase had returned to 5%.

6 A better indication of the underlying trend is provided by the output prices of manufacturing industry, which have been rising, year on year, by about 5½% for much of 1983. A similar picture emerges from the wider, but less speedily available, statistics of the deflator for the Gross Domestic Product. The picture is even

more encouraging if one looks at unit wage costs in manufacturing industry, which in the three months to August were only 1½% higher than a year earlier. In short, price inflation is currently down to between 5 and 5½% - ie only one-third of the rate three years ago - and the longer term outlook remains promising. But if we are to see the full benefits of the success to date, further progress is vital.

7 The UK economy is looking more healthy than for some time: output has been growing and unemployment has come down in two of the last three months. Of course, the base from which growth began was painfully low; and, as yet, the recovery has been narrowly based: consumer spending has been buoyant, but many other elements of demand have been subdued. For growth to be sustained, the base of the recovery will have to be broadened. But many of the building blocks for that sustained progress have been laid. In particular, British industry is now better placed to compete in world markets, thanks to major and widespread advances in industrial productivity.

8 Progress on what can be described as the intermediate targets of economic policy, such as the Public Sector Borrowing Requirement and monetary targets, is also broadly encouraging, but more remains to be done. Fiscal policy has brought down the Public Sector Borrowing Requirement as a percentage of GDP from 5¾% in 1980/81 to 3¼% in the last financial year, and this improvement should at the least be maintained in the current financial year. In comparison with the mid-1970s, when the PSBR approached 10% of GDP, progress seems formidable indeed. But the pressure for higher public spending is always present; and if the Government is to achieve its objective of cutting the PSBR to around 2% of GDP by 1985/86 without raising the burden of taxation, considerable restraint will continue to be necessary.

9 The money supply will also need to be kept under firm control. Here, a number of aggregates are of concern to us, and all are - or have been - affected by rapid structural and technological change: the bare figures must therefore be interpreted with some care. At present, the growth of the three aggregates for which targets were set at the time of the last Budget remains at or somewhat above the top end of their target range of 7-11%. This is better than during the summer but leaves no room for complacency, not least because monetary control is not an exact science. Lord Beveridge once said that "the State is or can be master of money. But in a free society it is master of very little else". I might add that mastery even in this one area is far from simple nor without painful choices.

10 If downward pressure on inflationary expectations can be maintained, I would hope to see sustained economic growth, accompanied by significantly lower interest rates. You will, I hope, forgive me if I refrain from being more precise. The adage that "forecasting is difficult, especially if it is about the future" is a true one; and, of course, many factors are outside the Government's control. All that the Government can do, in an economy as open as ours, is to plan on the basis of the most likely course of world activity and prices, standing ready to adjust its

policies, as necessary, in the light of major unexpected developments. Nevertheless, much of the hardest work to improve this country's position has been completed, despite a world background that has not always been as stable or as helpful as we might have wished.

11 As economic activity recovers, it is important to leave room for the expansion of the wealth-producing private sector if we are to achieve balanced, sustainable growth. Public sector spending must be restrained, and that means arresting a tide that has run one way for a very long time.

12 To illustrate what I mean, let us look at the central and local government shares of GDP over the 25 years between 1957 and 1982. In that time, their share of expenditure, calculated on the most conservative basis - to include only purchases of goods and services, has risen from 20% to about 24%. On top of this, taxes have to be raised, not only to pay for increased pension and other social benefits, which have more than doubled from 8% of GDP to 17%, but also to service the debt. The interest burden has risen slightly, with higher nominal interest rates more than offsetting a fall in the debt as a share of GDP.

13 Altogether in 1982, central and local government spent over 45% of GDP, against 32% in 1957. In these terms Government spending has been increasing nearly twice as fast as GDP. In recent years, when the average rate of growth of GDP has been well under 1%, the disparity has been substantially greater than two to one, despite the Government's efforts to restrain public spending.

14 It is, of course, reasonable to note that the benefit element in public spending will have been raised in recent years as a result of the low level of activity in the economy, and that inflation has changed the relationship between the interest bill and the real cost of the national debt. These factors cannot, however, disguise the trend. It is also the case - as a statistical matter - that the way Government output is measured in the National Accounts may cast it in an unfavourable light. Much of the output of the government sector is measured simply by its inputs, so that gains in productivity are not taken into account. One does not ask "what have teachers produced?" but rather "how many teachers are there?". For the private sector, in contrast, as for the public corporations producing for the market, an attempt is made to measure productivity gains, despite the problems involved in doing so.

15 I accept that public spending fulfills vital needs and that there are always areas in which a good case can be made for spending more. The Italian proverb - that public spending is like holy water because everyone helps themselves - is, however, not without an element of truth; and the Government - rightly in my view - has concluded that the public sector's claim for an ever growing share of national resources must be resisted.

16 It is not for me to say how the available money should be allocated between the competing demands for it. Nor do I wish to enter into a detailed discussion of how the financial arrangements

between central and local government should operate. The issues involved in such a discussion go far beyond those which naturally fall within the sphere of the central bank. It may, however, be appropriate for me to observe that a balance must be found between a worthwhile degree of local autonomy, without which local government is a sham, and sufficient cohesion for the public sector as a whole to operate in line with the Government's macro-economic policies. There are, perhaps, four broad implications of all this for the future.

17 First, because Government wants to see overall public spending fall as a percentage of GDP in the next few years, restraint in all parts of the public sector will be necessary. The need for restraint would be less, of course, if one made over-optimistic assumptions about the likely rate of economic growth in this period. Rapid growth is to be hoped for; but its benefits must be allocated after they have been earned, not before. Local authorities can reasonably ask, however, that central Government should not impose additional responsibilities onto them unless the cost of these responsibilities is allowed for in the constraints within which they must work.

18 My second point is that <u>all</u> expenditures need to be reviewed. Up to now, capital spending has suffered most from restraint. In your own case, current expenditure has exceeded the relevant provision in the Rate Support Grant settlements by between 6% and 8% in each of the last three financial years, while your capital spending, which is directly subject to cash limits, has increasingly undershot - by over 20% in the 1982/3 financial year. Up to a point, that is not surprising. It is easier to postpone the building of a new library or road than it is to find economies in the maintenance of those which exist already. It is also the case that capital spending often adds to subsequent current expenditure. Whatever the benefits to the community at large from a new local government project, they rarely do much to increase the income from rates and they often impose substantial new running costs. Nevertheless, it is important for our future to get the right balance between current and capital spending, and it is not clear that this has yet been achieved.

19 Third, it is important for the conduct of economic policy that accurate information about the revenue and expenditure positions for all parts of the public sector is available speedily, and that spending plans are adhered to. At present, the public sector has some way to go in this respect. For instance in the last two Budgets, the Chancellor of the Exchequer offered a forecast for the public sector borrowing requirement in the then current financial year that in the event proved to be in error by over £1½ billion - even though, when he spoke, the year had only about three weeks to run. Figures on the position of local authorities are particularly slow to arrive and are incomplete when they do come. Of the forecasting errors I have just described, over one third each year related to local authority borrowing.

20 This lack of precision would not be tolerated in a group of private companies, even where central management believed in substantial financial autonomy for its associates. It is equally unsatisfactory in the public sector, where policy is often made on the basis of inadequate and uncertain information about recent events within the public sector itself.

21 Finally, in respect of the balance between local autonomy and its responsibility to central Government, local authorities must remember the importance of rates in the costs of many industries and the fact that a growing proportion of local authority income has been provided by non-domestic rates. These represented some 27% of local authority rate fund revenue in 1982/83, against only 22% in 1976/77. Over the comparable calendar years - ie from 1976 to 1982 - the rate bills for industrial and commercial companies have increased by some 130%, against a rise of roughly 90% in their wage and salary bill and a 70% increase in the prices paid for fuel and materials used in manufacture.

22 The impact of non-domestic rates undoubtedly varies greatly between types of industry - most obviously because the rental value of land and buildings required by each also varies. For many smaller firms in distribution and services, rates are therefore a heavy burden. There are also problems resulting from the fact that many valuations are over ten years old. The decline of an industry will often be associated with a fall in the rental value of related assets, either because they are specific to the trade or because the industry is localised and thus property in the area is affected. In these cases the rate burden is unfairly distributed. This is separate from the point that, unlike profits, rental values, and, even more so, rateable values do not vary over the economic cycle. Unlike corporation tax, the rates bill is as large in bad years as in good.

23 Unfortunately, I cannot demonstrate these points clearly from the available statistics. Let me just note that the rate bill for industrial and commercial companies now exceeds £4¼ billion a year, and is probably over half the total that they are spending before tax on the interest payments on all their borrowing. Put another way, suppose that industrial and commercial companies had paid no rates last year and that this had been fully reflected in their profits. Then the profitability of those companies not involved in North Sea oil activities would have risen by over one-third in real terms - ie on the basis of current cost accounting. The rate burden <u>is</u> substantial for many businesses, and it is a burden over which they have little control, because they have no vote and because they cannot generally move either quickly or cheaply to a lower rate area.

24 Let me now turn to recent trends in the size, maturity and financing of local authority debt. The picture here is encouraging, not least because receipts on the sales of council houses and other assets, together with a low underlying level of capital spending, have greatly reduced your borrowing needs in recent years. Thus in the last two full financial years the borrowing requirement of the local authorities averaged only

£150 million, against £2,600 million in the previous two years. At a time of often high nominal interest rates and volatile market conditions, it must have been helpful to you that you were not having to seek large amounts of new money.

25 Second, the average maturity of local authority debt has lengthened, with the period for new term borrowing in the last couple of years averaging around eight years, more than double the length of such borrowing in the mid-1970s. This development, like the slower growth of your debt overall, can only have been beneficial to the authorities' standing with - and flexibility in - the financial markets.

26 I should add, at this point, that it is important that the proposed changes to the structure of local government and to the powers of central vis a vis local government should not affect the reputation of local government in financial markets. On this subject, I welcome the assurances given by the Government, both in the White Paper on "Rates" and in the more recent White Paper entitled "Streamlining the Cities".

27 Finally, there has been a marked shift in the sources of local authorities' borrowing - away from the banking system, which now accounts for around 20% of total outstanding debt, and towards the Public Works Loan Board, which lent £4¾ billion in the year to June, taking its share of total debt to nearly half.

28 The Government has actively promoted this switch in your sources of borrowing. Its first step - in August 1982 - was to introduce variable rate facilities for Public Works Loan Board loans, something which local authorities had requested for some time. The terms on these facilities were initially set at levels that were very competitive with the comparable market rates and they were cut again after only four months, to become an undoubted "best buy" of their kind. Additionally, in November last year, the Government substantially increased the authorities' 1982/83 PWLB borrowing quotas and has maintained these higher quotas into the current financial year.

29 The benefits of the changes in PWLB facilities have been twofold. Most important for local authorities, their cost of borrowing has fallen. Eighteen months ago it was not uncommon for local authorities to be borrowing variable rate money from banks at a margin of ⅜% or more above the London interbank offered rate (the usual reference rate for this type of borrowing); such funds are now available from the PWLB at LIBOR + ⅛%. Government can borrow more cheaply than the authorities, and it has passed on much of the benefit of this.

30 Also, and this is of particular relevance to us, the operation of monetary policy has been eased in one respect by the increased use of PWLB loans. For some time now, monetary policy has operated in a way that, as a necessary by-product, has required the banking system to make heavy net payments to the Government. The Bank of England has needed to respond by channelling the necessary funds back to the banks, mainly by buying bank bills. Local authority

borrowing from banks has contributed in considerable degree to the need for - and the size of - these flows. It makes no sense for local authorities to borrow from the banks - paying them for their intermediation - only for the banks then to refinance their lending by, in effect, borrowing in their turn from the central authorities. Consideration was therefore given to ways in which the Government could supply funds directly to local authorities on terms which would be more attractive than borrowing from banks.

31 The results of this deliberation were the changes I have described. These changes have helped, but they have not solved the problem because, although it has been reduced, the outstanding amount of local authority borrowing from banks is still substantial and it remains desirable that local authorities should continue to use fully the facilities now available from the PWLB.

32 Let me conclude, Mr Chairman, by stressing that much of the effort needed to set our economy on a sound footing has already been put in. Nevertheless, there is more to be done; and, over the next few years, the restraint - or lack of it - shown by the public sector in its spending will be of critical importance in determining the success of Government policy.

33 What will be asked of all parts of the public sector goes beyond "good housekeeping". That, of course, is important, but it is not enough. Mao Tse-tung once said that "thrift should be the guiding principle of our Government expenditure". You would not expect the Governor of the Bank of England to quote too often or too approvingly from such a source but here I would wish to amend just one word: thrift must be <u>a</u> guiding principle. In addition, some difficult choices will have to be made if the hitherto inexorable rise in the share of public sector spending in the national cake is to be reversed. But reversed it should be, if the benefits which local authority treasurers and their private sector counterparts have already seen from the decline in inflation are to be consolidated and extended into sustained economic growth. Only out of that growth, in the long run, can come additional resources for use by the public sector.

cc NO.

Prime Minister

B

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Patrick Jenkin MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
LONDON
SW1P 3EB

11 November 1983

Dear Secretary of State

GRANT AND HOLDBACK FOR LOCAL AUTHORITIES IN 1984-85

Pt 17 I am sorry you have felt it necessary to re-open the settlement we reached last month in E(LA). Before colleagues meet next week to discuss your paper on holdback, I ought to make my own position clear.

I went to the limit in accepting grant of £11.9 billion and holdback of 2-4-8-9-9. Grant is too high to deliver spending near target. The targets will again be overspent, and the taxpayer will finance much of the overspending. I am not prepared to compound that problem.

The two options in your paper would increase both grant and public expenditure. On your assumptions, one would increase grant after holdback by about £75-150 million; the other by about £130-250 million. This would raise the burden on the taxpayer. It would also lead local authorities to spend more.

We went into the settlement with our eyes open. We knew that it could imply large rate rises, on certain assumptions, even in some of the Shires . We accepted it on that basis.

Since then, you have shown us a way of reducing the Shires' burden without any change in the agreed aggregates. The figures attached to your E(LA) paper assume a redistribution of GREs which would (i) significantly improve the Shires' prospects. This is illustrated in the following table. It shows prospective changes in "local contributions" in the Shire counties, on different assumptions about expenditure. The first line shows your Department's best estimate at the time we agreed on holdback of 2-4-8-9-9. The second line shows the estimate you have now circulated. The third line shows - from your latest tables - the effect of relaxing holdback.

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SHIRE COUNTIES' % INCREASE IN LOCAL CONTRIBUTIONS ↙ In effect rates.

		Budget + 3%	Budget + 4%	Budget + 5%
Holdback				
2-4-8-9-9				
October	$1\frac{1}{2}$%	5.8	10.1	15.5
November	→	4.2	8.6	14.0
1-3-7-9-9		3.5	7.5	12.5

The striking thing is that we can reduce the prospective average rise in local contributions in the Shire counties by about $1\frac{1}{2}$% without any relaxation in holdback. For moderate spenders, the change you propose in holdback would be worth only about half that - $\frac{3}{4}$-1%. I cannot believe that the game is worth the candle.

I understand, of course, that some of our supporters have considerable misgivings. But we have a reasonable reply to the main charge, which is that we are being unfair to a large number of responsible authorities.

a. Their targets allow them to spend without holdback 3% more than their budgets for this year - even though several of those budgets are above this year's targets. They should spend a bit less than their budgets this year, especially if they know that next year's settlement will be tough. So the targets might allow roughly 4% more spending next year than this.

b. Two-thirds of that spending is on pay, for which our own "pay factor" is 3%. It is scarcely unreasonable to ask Tory councils, elected on a platform of economy, to increase their spending by 3-4%.

c. If they meet their targets, they will get generous grant. For the first time since 1980-81, we are making less than a 1% change in the RSG percentage. It has recently come down by about 3% a year.

d. If they exceed their targets, we shall indeed withdraw grant quite rapidly. That is partly because we are giving them a lot of grant to start with. It is also because holdback is meant to be a deterrent.

e. If they overspend slightly, most responsible authorities will face a modest rate increase. Even if they spend 5% more than their budgets for this year, instead of 3%, your figures show only 5.3% for Buckinghamshire, 5.6% for Cambridgeshire, 8.1% for Kent, 10.8% for Surrey.

This has to be seen in context. Over the last few years, even our supporters have in the main increased their spending quite rapidly. Since 1981-82, for example, local authority costs have risen by about 13%, roughly in line with prices generally. Suffolk has increased its spending by 16½%, Somerset by 16%, Cambridgeshire by 15%. (ii)

I have noticed, for example, the recent complaints from Devon. Over the same period, it has increased its spending by 16% - a real increase by any measure. If next year it spends 3% more than its budget for this year, it need not increase its rates at all. Even if it spends 5% more than this year's budget, it need only raise its rates by about 6¾%.

Of course there are harder cases. But whatever the individual merits, I cannot believe that they merit a general relaxation. The one you propose would confer the largest benefit not on our supporters but on the largest overspenders: the cumulative relaxation in holdback would be greatest for those overspending by 3% or more.

(iii) I know that we must have an eye to our rate-capping legislation. But I do not believe that the doubters in the House will become even grudging supporters of the legislation because of changes in holdback. More likely, a concession now would increase the pressure for more in that context. Nor do I think it would be right, while there is any question mark over rate-capping, to give up on the restraints we have got. I am appalled by the suggestions in the Press that, to secure selective rate limits on 15-20 authorities, we might be prepared to relax the pressure on the other 400 by abandoning targets and holdback.

I believe strongly that we should stand firm on the settlement we have announced. I should be happy to consider marginal adjustments, for example by redistributing GREs, or by reducing both grant and holdback. But I cannot accept a net relaxation in the settlement.

I am sending copies of this letter to the Prime Minister, members of E(LA), the Chief Whip and Sir Robert Armstrong.

Yours sincerely

J. Grieve

f- PETER REES

[Approved by the Chief Secretary]

14 NOV 1983

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NBPM
at this stage
AT 7/11

ce NO

WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switchboard)
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From The Secretary of State for Wales

7 November 1983

Dear Secretary of State,

WELSH RSG SETTLEMENT 1984/85

Pt 17 I have seen a copy of your letter of 31 October to the Chief Secretary. At the request of the Prime Minister, Peter and I are continuing our bilateral discussions, taking full account of your views which are well-known to us.

In the meantime I feel I must respond to some of the points you make in your letter which are mistaken.

To begin with, you say that the Welsh target methodology seems a great deal less tough than the English, especially for the highest Welsh overspenders. Let us get this into perspective. In the current year, three of the eight Welsh counties (which account for 83 per cent of Welsh local authority current expenditure) are planning to spend at target and none of the remainder have budgeted to spend above the 10 per cent threshold; the counties' budgets in aggregate are only 2.9 per cent above their aggregate GRE. So far as the Districts are concerned, only four out of the thirty-seven are spending above the threshold; in aggregate their budgets are 3.6 per cent below their aggregate GRE. If you could see a similar pattern for all authorities in England I am sure you would be pleased. We have reached this position by consistent application of a target methodology which has only been altered when absolutely necessary, and then only in minor respects. This gives local authorities the certainty they need if they are to respond responsibly to our plans. Thus every year since we established the Welsh RSG system we have had fewerr authorities budgeting to spend above the threshold. The Welsh methodology obviously works, and it would be nonsensical to interfere with it solely on the grounds of complaint by authorities subject to a different system necesarily tailored to very different circumstances.

As regards the comparative cash increase in AEG, I am afraid that this has limited public and political significance in Wales. The politically vital comparison is the rate increase effect on any given set of assumptions. Of course we are not talking about forecasts. But I am always challenged on the rating effects of a Wales settlement, and it has been essential for me to show, both in the Welsh Consultative Council and in Parliament, that the comparable rating effects on common assumptions do not disfavour Wales, particularly in the light of the performance of Welsh authorities in their current spending which has been excellent compared to the dismal record in England. I have to observe that you based almost the whole of your argument in E(LA) on the rating consequences of the decisions we were taking, particularly against the background of the difficulties we will face over our rate-capping legislation.

The Right Hon Patrick Jenkin MP

The AEG figure of £995 million you suggest would be inadequate to produce rating effects at all comparable with the England settlement and so is unacceptable to me. I am pursuing the questions of the right quantum with Peter Rees.

On holdback, you have not understood the position in Wales. No doubt because Welsh authorities, unlike English ones, expected aggregate expenditure to be near our planning figure, they did not rate for holdback in 1983/84; the holdback which occurred was met largely from balances. This is illustrated by the fact that the £12.6m holdback in Wales this year would have required a 4.7p rate, whilst the average general rate poundage increase was in fact 1p. Accordingly there is no case on these grounds for the holdback scheme to be toughened in Wales although there was in England.

I am copying this letter to the Prime Minister, Peter Rees and Sir Robert Armstrong.

Yours sincerely

J H Roberts

Approved by the Secretary of State
and signed in his absence

Local Govt: Relations

Pt 18

10 DOWNING STREET

Prime Minister

To be aware that distribution of RSG is now being discussed. Mr Jenkin is proposing only minor changes on 1983-84 mechanisms.

AT 4/11

MT

file

DOE

MR. TURNBULL

The Chief Whip had a word with me about Mr. Jenkin's proposals on legislation to control the rates. Apparently Mr. Jenkin is putting forward to one of the E Committees some modifications in his original proposals and has asked the Chief Whip to go along to the Committee to advise on whether they can be got through the House. The Chief Whip feels that getting them through the House will not depend only on the proposals themselves but on the efforts which DOE Ministers make to sell them to the various local authorities concerned; and he feels that this effort has so far been lacking. The Chief Whip may want to invoke the Prime Minister's aid in getting this message across to Mr. Jenkin, and the natural opportunity to do this would be when Mr. Jenkin clears his proposals with the Prime Minister.

Could you please look out for that moment and alert me when Mr. Jenkin reports to the Prime Minister.

F.E.R. BUTLER

4 November 1983