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SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB
01-276 3000

My ref:

Your ref:

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Dear Paul

LOCAL AUTHORITY GRANT SETTLEMENT 1989

Since the Prime Minister's meeting on 25 May, my Secretary of State has been considering further with the Chief Secretary the best form of a possible grant settlement which could be put to colleagues for the E(LF) discussion next Thursday.

2. One new factor which Mr Ridley has been considering with Mr Major is the position of London, and in particular the inner London boroughs which are taking over education from ILEA. The boroughs will be inheriting ILEA's high spending levels, and inevitably it will take them a year or two to trim this down to more reasonable levels even those boroughs which have the will to do so. School closures will be needed in many areas, and that would take some time to carry through.

3. Following some analysis of this post-ILEA problem by officials Mr Ridley and Mr Major are persuaded there is some force in these arguments, and that it would be helpful to provide a special specific grant for the inner London boroughs phased out over three to four years to ease the problem of transition and managing the scaling down of excessive spending. They envisage a grant of £100 million in the first year which would need to be top-sliced from the total of Exchequer grant. A small amendment would be needed to the present power to pay grant to the inner London boroughs to prepare for taking over education. This could be added to the current Local Government and Housing Bill in the Lords.

4. Taking this into account they then had another look at the main aggregates which have to be determined:

- The total standard spending level (the new phrase which they propose to replace the term "need to spend"), and
- the level of Aggregate External Finance (AEF).

5. On the standard spending level some additional technical adjustments to the base line have had to be made for financing items since the Prime Minister's meeting. The Secretary of State now therefore thinks it reasonable to fix this figure at £32.8 billion, £100 million more than the Option C previously discussed; John Major has reluctantly agreed.

6. On the level of Aggregate External Finance in order to provide head room for the proposed ILEA grant, and taking account of the technical financing changes they now think it reasonable to go to £23 billion, £200 million more than previous Option C. This would give a community charge for standard spending (CCSS) of £275.

7. The most important point which they have then been looking at further is the safety net. The existing safety net proposals envisage that in the first year authorities which stand to lose grant in the longer term should receive broadly sufficient extra safety net grant to ensure that their average community charge for spending at their 1989/90 level in real terms should not have to go up from the average 1989/90 rate bill per head by more than 4% if they spend at the standard level. In order to finance that protection, authorities standing to gain grant and thus have lower community charges in the longer term, would have to contribute up to a maximum of £75 per head to pay for the safety net.

8. It is becoming increasingly clear to my Ministers however from the pressures building up that this blocking of "legitimate" gains will be deeply unpopular, particularly among some of the Government's own supporters, and that many charge payers in gaining areas will be highly indignant at having to pay up to an extra £75 per head to keep down charges in other areas many of which are spending excessively. My Secretary of State and the Chief Secretary have therefore been considering whether there is any way in which more of the gains could be allowed to come through more quickly.

9. They do not want to depart from the self financing principle for the safety net which is built into the legislation, i.e. that any protection for losers must be paid for by restricting first year gains. But they do think they could give a much better first year deal to many of the gainers by allowing a small part of the losses to come through in the first year. One possibility would be a revised safety net scheme on the following lines:

(i) Losses up to £25 per head to be allowed to come through in the first year, with any larger losses being off-set by safety net grant. This degree of protection would cost £620 million (as against (£950 m) for full safety net) and would benefit 102 authorities.

(ii) This safety net is to be paid for by allowing authorities to keep gains up to £20 and 25% of any gains above that in the first year. This would mean 168 authorities contributing to the safety net.

10. Under this arrangement the 54 authorities which stand to lose less than £25 per head, and the 42 authorities which stand to gain less than £20 per head would not be involved in the safety net at all, either as contributors or beneficiaries. This is a very considerable advantage in terms of simplifying the presentation, but particularly in eliminating the need to show safety net adjustments in the community charge bills for those authorities. The maximum loss of £25 per head is fairly modest, and likely to be lost in all the other consequences of the change from rates to community charge. And spreading the gains so as to give all gainers any gain up to £20 per head in full, and then a percentage of their long term gains above £20 seems to give a fairer distribution than the earlier proposals. It would however reduce the first year gains of the largest gainers such as Westminster and some of the Buckinghamshire authorities very considerably.

11. There could be other variants here which will need to be considered further, within the general constraints of the total of grant here proposed and the self financing principle for the safety net.

12. My Secretary of State is very conscious that the aggregate figures he is now preparing are higher than the range indicated by the Prime Minister at the earlier meeting. He and the Chief Secretary have however examined them very carefully, and they feel confident that with the Prime Minister's support it should be possible to defend this package against the further pressures that other spending colleagues may bring to bear next Thursday as indicated by the paper they are circulating separately. It is on that basis that Mr Ridley seeks the Prime Minister's agreement to his putting these revised proposals to colleagues.

13. I attach a draft E(LF) paper setting out these proposals which we would circulate on Monday for next Thursday's meeting if the Prime Minister is content.

14. Exemplifications are also attached, and E(LF) will no doubt want to look at these very carefully. In Mr Ridley's view the proposals he is now making are by no means excessively generous. The Exchequer grants total will only go up by 5% from this year, below the rate of inflation. Such a settlement is likely to result in actual community charges which will average around £300 per head assuming they spend only 7% above 1989/90 budgets and will be considerably more in some places. Such a settlement will be seen as a tough one and is likely to come under considerable attack when it is published in July. The Secretary of State sees this however as the price that must be paid to ensure that the accountability pressures of the community charge begin to operate on local authority spending decisions right from the start next year.

15. On the safety net my Secretary of State has not been able to see the latest exemplifications which have been prepared today, and will want to consider fine tuning this part of the proposals, particularly about the treatment of gainers, over the weekend.

16. I am copying this letter to the Chief Secretary's Private Secretary and to Richard Wilson.

Yours
Roger

ROGER BRIGHT
Private Secretary

Paul Gray Esq
Private Secretary
10 Downing Street
London SW1