THE IMPACT ON LOCAL AUTHORITIES' ECONOMY, EFFICIENCY AND EFFECTIVENESS OF THE BLOCK GRANT DISTRIBUTION SYSTEM
The Impact on Local Authorities' Economy, Efficiency and Effectiveness of the Block Grant Distribution System

A Report by the Audit Commission

August 1984
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Synopsis

The Audit Commission for Local Authorities in England and Wales (the Commission) has reviewed the impact on local authorities' economy, efficiency and effectiveness of the present system for distributing £8.6 billion of grant in aid to local authorities. The Commission is of the opinion that major changes are now desirable.

Specifically, the Commission has found that:

(i) There are too many unnecessary uncertainties inherent in the system. These inhibit authorities from planning ahead. The lack of forward projections of central grant support to local authorities and the annual changes in expenditure targets and penalties pose particular problems for authorities and government.

(ii) Authorities have been building up reserves at an annual average rate of at least £400 million a year over the past three years - well above two-and-half times the average annual rate of increase in reserves prior to 1981-82, when the present Block Grant system was introduced. If the uncertainties referred to in (i) above could be reduced so, the Commission believes, could the need for reserves.

(iii) Because some information on local needs is often inadequate and that on local resources is out of date, serious distortions result. Some authorities are receiving less grant than their circumstances might warrant; and, by the same token, some are receiving more. The difference for a large city could easily amount to ± £15 million in grant every year.

(iv) The introduction of targets partly related to past expenditure has encouraged some authorities to spend more, to secure more grant - a perverse incentive that the present system was designed to avoid; and the gap between targets and grant related expenditure is generally widening.

(v) Managerial accountability for local services has not been strengthened as was the intention of the new Block Grant system; and central involvement in local affairs does not seem to have been reduced, as was also intended.

(vi) Because of its complexity, few people in local government understand fully the basis on which grant is distributed, despite its significance for local services; and changes in local rates - one of the yardsticks against which ratepayers measure their authorities' performance - are not a reliable guide to individual authorities' changes in expenditure.

(vii) The present grant distribution system provides few incentives for local authorities to improve their efficiency and effectiveness; and there are a number of centrally imposed constraints.

The Commission recognises that the Block Grant system is a result of many pressures upon government. However the present system is being used to try to secure at least four different objectives which are not mutually compatible: to distribute grant in a way some of which reflects local needs and resources, to control aggregate local government expendi-
ture, to ensure that individual authorities do not exceed their spending targets and to limit rate increases from year to year for individual ratepayers. Moreover, this review shows that the system which now exists is producing information on current expenditure levels that is misleading to policy makers in both central and local government.

Based on its work so far, the Commission is also of the opinion that there are substantial opportunities to save money in local government, without adversely affecting services. The savings involved will go some way to meet new needs and demands for services at reasonable costs to local ratepayers. Changes in the way £8.6 billion of Block Grant is distributed to individual authorities could facilitate the achievement of these benefits.

A detailed review of the present arrangements for grant distribution should be undertaken to devise solutions to the problems that this report has identified. While the Commission is not empowered to do more than report on the impact of the present grant distribution arrangements on local economy, efficiency and effectiveness, the final chapter of this report suggests the outlines of a possible way ahead.
Introduction

1. Local authorities in England manage services which now cost about £30 billion a year, or some £1,600 for the average household. This expenditure is funded from a variety of sources. On average central government meets around 40 per cent of gross expenditure, through Block Grant and other subsidies, ratepayers also provide roughly 40 per cent and the balance comes from tenants and the users of services. However the proportions vary from authority to authority depending on the services provided, the local rateable value and the extent to which total expenditure in the authority in question conforms to targets established by the government. Some authorities now receive no Block Grant at all; at the other extreme, there are some authorities where Block Grant amounts to 65 per cent or more of total expenditure.

2. For the last five years, central government has been seeking to control total local authority expenditure as well as seeking to meet other objectives including:-

   (a) securing a more objective means of distributing grants to local authorities;
   (b) a greater degree of equalisation in rate poundage terms, as between local authorities providing a common level of services - so far as it is consistent with other objectives;
   (c) discouraging further spending by the so called high-spending authorities by reducing or eliminating the incentives within the grant system to higher spending;
   (d) making the grant system more readily understandable to members and officers within local government;
   (e) increasing local accountability for spending decisions;
   (f) reducing the number of civil servants and the extent of central intervention in local government decision-making.

3. In pursuit of these objectives and for other reasons government has taken five major initiatives since 1979:-

   (i) Grant has been reduced. The aggregate level of central government support to local authorities was at its peak in the financial year (FY) to March 31, 1976 for England and Wales, when it amounted to 66.5 per cent of relevant expenditure. Support has generally been falling in percentage terms since then. Recently it has been reduced in Rate Support Grant Settlements for England from 60 per cent of relevant expenditure in 1980-81 to 51.9 per cent in 1984-85 — equivalent in today's terms to a reduction of £1.86 billion, or £100 a year per household. A further, sharp, fall for 1985-86 has just been announced;

   (ii) The Block Grant system was introduced by the Local Government Planning and Land Act 1980 and was designed to meet all the objectives outlined above. Within the Block Grant framework, a new system of needs assessment called Grant Related Expenditure (GRE) was introduced to provide a measure of the cost for each local authority of providing a common level of service;
EXHIBIT 1

TRENDS IN REAL LOCAL GOVERNMENT EXPENDITURE* 1971-83
Index: 1971=100

*Deflated by income from employment index (current expenditure) and index of prices for domestic fixed capital formation
Sources: DOE; Audit Commission analysis of National Accounts Statistics, Table 8
(iii) A succession of targets and penalties was overlaid on to the Block Grant System which has generally made it more expensive from year to year for an authority to spend above the expenditure targets set by the government. Normally the effect has been to withdraw Block Grant progressively as an authority’s expenditure exceeds the target;

(iv) The powers of local authorities to levy a supplementary rate and precepts were withdrawn by the *Local Government Finance Act 1982*;

(v) A new system of controlling local authorities' capital expenditure was introduced by the *Local Government Planning and Land Act 1980*, which replaced the old system of controlling the borrowing to finance capital schemes with a series of capital expenditure allocations for individual authorities. (Since this report deals with Block Grant and its effects this particular system is not discussed further).

These different initiatives have interacted, to form a complex system which seeks both to distribute Block Grant and to exert some control over individual authority's expenditure levels. The table below illustrates the impact of some of these changes on a northern metropolitan district with relatively high rateable values that has kept aggregate expenditure since 1979-80 in line with movements in the retail price index (RPI)*, and in spending below GRE and target:

<table>
<thead>
<tr>
<th>Year</th>
<th>Expenditure (net)</th>
<th>Rate Support Grant</th>
<th>Rates &amp; Balances</th>
<th>% Change 1980–84</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY1980</td>
<td>72.2</td>
<td>34.4</td>
<td>37.8</td>
<td>+ 1.0</td>
</tr>
<tr>
<td>1981</td>
<td>75.3</td>
<td>36.2</td>
<td>39.1</td>
<td></td>
</tr>
<tr>
<td>1982</td>
<td>72.2</td>
<td>29.4</td>
<td>42.8</td>
<td></td>
</tr>
<tr>
<td>1983</td>
<td>72.5</td>
<td>26.3</td>
<td>46.2</td>
<td></td>
</tr>
<tr>
<td>1984</td>
<td>72.9</td>
<td>22.4</td>
<td>50.5</td>
<td></td>
</tr>
</tbody>
</table>

The table shows that net expenditure has remained about constant in real terms while RSG has declined - with a consequential increase in contributions from rates and balances.

4. This system has not been successful in achieving the Government's objectives, as the White Paper on *Rates* (Cmnd 9008) acknowledges: "More economies are required from all authorities, including those that have in part at least complied with the government's expenditure targets". As Exhibit 1 opposite shows, the total reported current expenditure by local authorities in England and Wales has not been reined in, while capital expenditure has fallen very considerably. In money terms local government revenue expenditure has, of course, continued to increase - in many cases faster than the earnings of local business and individual ratepayers. Reported expenditure by local authorities continues to exceed the government's targets, by almost £655 million in 1983-84.

5. The Government has announced its decision that "rates should remain for the foreseeable future the main source of local revenue for local government". The Audit Commission for Local Authorities in England and Wales (the Commission) has therefore decided that this is an appropriate time to examine the present arrangements for distributing Block Grant to local authorities, to determine whether they are promoting economy, efficiency and effectiveness in the provision of local authority services. The Commission is required under Section 27 of the *Local Government Finance Act of 1982* (which established the Commission) to undertake or promote

* Not necessarily the most appropriate deflator, but that used by the authority.
studies designed to "enable it to prepare reports as to the impact of the
operations of any particular statutory provision or provisions or of any
directions or guidance given by a Minister of the Crown . . . on economy,
efficiency and effectiveness in the provision of local authority services or on
their financial management".

6. As the Code of Local Government Audit Practice makes clear, it is not
the auditors' function to question a local authority's policy. By the same
token, it is not the Commission's responsibility to challenge government
policy. It follows that this report takes no view on policy questions, such as:
what local authorities should spend in total, what grant they should receive
in total, what policies Government may have which affect local authorities
expenditure differentially, or the priorities that decide the distribution of
Block Grant between authorities.

7. Rather the Commission is looking at the effects of the existing
arrangements from a managerial standpoint. In this review as in its other
work, the Commission is concerned with questions of management: is the
present system for distributing central government grants to individual
authorities promoting sound management of local services. Specifically it is
emphasising the following basic requirements for sound management:

(a) Delegation of authority and responsibility as far down the line as
possible. This principle of management lies at the heart of successful
businesses. The Financial Management Initiative launched by the
government to improve management within the Civil Service lays
great (and the Commission believes appropriate) stress on its
application in the public sector;

(b) Effective local accountability. The Commission considers that eco-
nomy, efficiency and effectiveness will best be served by well
informed locally elected members holding officers accountable for
the way money is spent;

(c) Longer-term strategic perspective. Any well-run organisation requires
a reasonable medium-term planning horizon if it is to make effective,
economic and efficient use of the resources at its disposal. Perhaps
the most difficult task facing authorities is the need to redeploy
manpower. Abrupt shifts in manpower are almost invariably un-
necessarily expensive and cause serious and lasting damage to local
labour relations. In local government, where staff turnover often
exceeds ten per cent or more a year in some departments, natural
wastage is normally less costly and disruptive. But using natural
wastage to secure the necessary redeployment of staff is only possible
if authorities can take a longer-term (i.e. 3–4 years) view;

(d) Positive incentives and encouragement. Organisations as well as
individuals require positive incentives and encouragement as well as
sanctions. Ideally, the arrangements for distributing central govern-
ment grants to local authorities will provide incentives to secure
better value for money as well as sanctions that will be applied where
authorities do not respond. At the very least, it is important to ensure
that the system does not provide perverse incentives - that is, that it
does not penalise authorities taking sensible steps and that it does not
apparently reward those failing to take appropriate action;

(e) Flexibility. Priorities change and urgent problems affecting individual
authorities arise which could not reasonably be anticipated. Any
system for distributing central government funds must be sufficiently
flexible to allow promotion of new policies and initiatives and to react
to the unexpected.

8. These managerial requirements will be referred to throughout this
report, as different aspects of the present grant distribution arrangements are discussed. The Commission believes that they can best be met if the grant distribution system is seen by local government members and officers to be clear, consistent, understandable and fair. Complexity does not contribute to effective local accountability and may reduce flexibility; uncertainty inevitably inhibits longer term planning; unfairness (whether perceived or real) induces a damaging cynicism in members and officers alike; and a system that is only understood by relatively few people inevitably leads to less - not more - delegation of authority and responsibility, weakened local accountability and attempts to manipulate the system - in effect 'robbing Peter to pay Paul'.

9. Over the past several months, therefore, the Commission has examined inter alia the present arrangements for distributing Block Grant to local authorities in some depth, to determine the extent to which these managerial requirements are met and the Government's stated objectives (paragraph 2 on page 3) have been satisfied. A team was established under the Commission's Director of Special Studies. At the outset of the work the team agreed on the key issues involved and how they would be addressed, and it discussed them with the Department of the Environment and the National Audit Office as well as with the local authority associations. The team has undertaken detailed analysis of publicly available expenditure information, using data provided by the Chartered Institute of Public Finance and Accountancy and Cambridgeshire County Council. Some of the issues were examined in fieldwork in sixteen different authorities, supplemented by an opinion survey completed by Chief Executives in over 180 authorities. Senior officers of the Commission have also taken the opportunity to discuss the problems involved in informal meetings with some 30 different groups of local authority members and officers across the country over the past few months.

10. This report sets out the Commission's conclusions that:

1. **The uncertainties associated with the present arrangements for distributing Block Grant to local authorities are now leading to higher rates than are necessary.** Over the past 2-3 years, General Rate Fund Balances have increased in total and the use of special funds has become more marked, as local authorities have sought to manage the significant annual uncertainties in the present system for distributing grants. For ratepayers, this means that rate bills in the last three years have probably been on average some £400 million or more a year higher than would have been necessary had there been fewer external uncertainties outside authorities' control. To this extent, the present arrangements are not promoting economy at the local level. The first chapter of this report explains the nature and extent of the uncertainties that the present arrangements for distributing grants have induced and sets out the evidence for our conclusion that the uncertainties can and should now be reduced.

2. **A potentially sound grant distribution system is being weakened.** The Grant Related Expenditure assessments (GRE) and the present equalisation machinery could provide a consistent, fair and understandable basis on which to distribute grants to individual authorities - provided that the misgivings about some of the methodology could be overcome. However, the approach is being weakened by superimposing expenditure targets and penalties and by the use of inadequate information - particularly on local needs and property values. As a result, the effectiveness of some local authorities in meeting local needs is reduced. Chapter two describes how the
present arrangements are undermining the potential of the Block Grant approach.

3. The pressures and incentives necessary to encourage local authorities to operate more economically, efficiently and effectively are not in place. While encouragement of efficiency and effectiveness is not among the main stated objectives of the present Block Grant system, the third chapter shows some unintended by-products: incentives are inappropriate; accountability for local services is blurred; local pressure for improvements in value for money is weaker than it needs to be if painful decisions to redeploy resources are to be taken; and there is an insufficient delegation of authority and responsibility to the local level.

11. It is not the Commission's purpose at this stage - nor is it required under the Act - to set out detailed proposals to correct the situation described in this report. However, the final chapter of this report suggests a possible way forward and indicates the general directions of the changes that the Commission has concluded are necessary, based on the findings of this study. Technical working papers identifying the main sources of information and methods of calculation have been prepared. The working papers summarise details of the findings of the macro-economic analysis, fieldwork, opinion research and of the survey among local authority Chief Executives in larger authorities in England and Wales. As stated above, many people in local government and elsewhere have contributed to this review. The Commission would particularly like to acknowledge the co-operation of those authorities participating in the fieldwork, the assistance of the Information and Research unit at Cambridgeshire County Council and the thoughtful additional contributions of many of the Chief Executives responding to the detailed questionnaire. Responsibility for the conclusions set out in this report rests, however, with the Commission.
1 The effect of new uncertainties

12. If local authorities are to redeploy their resources to meet new needs and demands, they must be able to plan ahead. In any organisation subject to changes in political direction, there is bound to be some difficulty in planning ahead in detail; and predicting the future is a hazardous undertaking at the best of times. Nonetheless, management must be able to take a medium-term view to secure significant changes in manpower. Indeed, government departments have a three-year planning horizon through the Public Expenditure White Paper which sets out the cash resources available for the next three years.

13. In these circumstances, it is disturbing that our review clearly shows that few local authorities plan more than twelve months ahead at least so far as current expenditure is concerned. Table 2 below, summarises the position as reported by Chief Executives in England.*

Table 2: Planning Horizon of Local Authorities
% Respondents

<table>
<thead>
<tr>
<th>Planning Horizon</th>
<th>Current Expenditure</th>
<th>Capital Expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 year</td>
<td>69%</td>
<td>12%</td>
</tr>
<tr>
<td>2 years</td>
<td>15</td>
<td>17</td>
</tr>
<tr>
<td>3 years</td>
<td>12</td>
<td>50</td>
</tr>
<tr>
<td>4 years</td>
<td>1</td>
<td>7</td>
</tr>
<tr>
<td>over 4 years</td>
<td>1</td>
<td>15</td>
</tr>
</tbody>
</table>

Despite the emphasis on corporate planning in the Bains report**, short planning horizons have probably always characterised local government. The current distribution mechanism has not however encouraged the longer view the Commission feels is necessary.

14. Failure to plan more than 12 months ahead is inevitably wasteful in a changing environment. Short-term decisions will be made, such as across-the-board expenditure cuts which are bound to be inefficient. Sensible manpower planning and development will be impossible - a major shortcoming in any people-intensive undertaking such as local government where wages and salaries account for about 50 per cent of annual gross revenue expenditure. In addition, effective co-ordination with other public bodies such as the Manpower Services Commission and the National Health Service with longer planning horizons is impeded with potentially serious consequences. For instance, some regional health authorities are now consulting relevant local authorities on plans for the next 8-10 years (despite the limitations imposed, incidentally, by the three years Public Expenditure Survey cycle) which assume that local government will provide more facilities for the elderly mentally infirm; but because they do not plan

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* The Commission has provided detailed feedback directly to the 186 respondents to its questionnaire, over 80% of those approached. This report refers only to the most significant findings from the survey.

** The New Local Authorities Management & Structure HMSO 1972
Nature and Extent of System - Induced Uncertainties

ahead, many of the local authorities concerned cannot responsibly give any firm undertakings beyond the next 12 months*

15. Local authorities are of course well aware of the risks involved in not planning ahead, and the various reports of the Financial Management Initiative have underlined the benefits that can flow from a longer term prospective. (See, for example, the report of the Management and Personnel Office and Treasury Financial Management Unit published in September 1983). Nonetheless, in general, authorities have failed to do so, citing as a major reason the uncertainties involved in the present arrangements for distributing central government grants. We have therefore examined the extent to which the present arrangements for distributing central government grants to local authorities can legitimately be cited as factors contributing to the failure of authorities to plan ahead. The rest of this chapter describes in turn.

(i) The nature and extent of the new system - induced uncertainties faced by local authorities

(ii) The extent to which authorities' response to the new uncertainties may have resulted in a greater build-up of reserves than would otherwise have been the case.

16. The world is an uncertain place. Officials will always be required to make informed assumptions about future central government policies, rates of inflation, movements in salary levels for major groups of employees; and reasonable reserves will always need to be held back.

17. However, the present arrangements for distributing central government grants to local authorities have introduced new uncertainties for local government. Every year for the past three years individual local authorities have received a provisional spending target in July and a final one in the late Autumn for the year about to begin in April. Each year, the basis for targets and penalties for 'overspending' has changed. As members and officers of local authorities look ahead, they have to make assumptions inter alia about:

(a) The total level of central government grant to local authorities
(b) Their authority's share of the total available grant.
(c) The expenditure targets and nature of the penalties for spending in excess of targets.
(d) Changes in grant entitlement likely as a result of other authorities' actual spending and subsequent grant entitlements.

The nature of the process and an indication of the points of uncertainty outside an authority's control is illustrated in Exhibit 2 (opposite), which shows the present system in outline form. Most, though not all, of the uncertainties arise because the system is seeking to achieve two objectives simultaneously: to distribute a given total amount of Block Grant and to control authorities' expenditure individually. The Appendix to this report describes the Block Grant system in more detail. The rest of this section discusses each of the uncertainties in turn.

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* c.f. West Berkshire Health Authority Draft Strategic Plan 1984–1994 (page 31) "As with services for the elderly, the [Oxford] Regional Strategy envisages non-residential care [for the mentally handicapped] wherever possible through domiciliary support services and local day care facilities, all planned jointly with local authorities [emphasis added] and voluntary organisations"
Local Councils face many external uncertainties

OUTLINE OF PRESENT SYSTEM FOR DISTRIBUTING GRANT

*All figures relate to 1984-85*
Uncertain Level of Central Support to Local Government

18. There are no long-term projections of government support for local authorities. Rate Support Grant (RSG) has since 1974 been announced for a single year at a time, with no indication of the likely overall grant percentage for the following year. Detailed information from which each authority's grant calculations may be made is not usually available before mid to late December each year, in respect of the financial year beginning three months later.

19. However, central government's objectives for local government expenditure are included in the government's public expenditure planning process. This involvement in planning stems from the introduction of the public expenditure survey system (PESC) in the early 1960s. The creation of the Consultative Council on Local Government Finance in 1975, which formalised local government discussion with central departments about spending and grants, has increased the flow of information from local to central government. In addition, successive governments have become interested in controlling the total of local authority current expenditure. This has meant discussions between central and local government about how to achieve reductions. These discussions have presumably influenced mainly the figures for each local authority service in the Public Expenditure White Paper reflecting the Government's priorities. An authority aiming to translate the Government's strategy into practice locally might be expected to scrutinise these plans with care as a guide to its future allocation of resources to services.

20. As part of the RSG System, the government publishes plans for local authorities on the assumption that authorities will take note of them. For example, paragraphs 5-7 of the "Rate Support Grant Report (England) 1984/85" state:

"the Secretary of State and, where appropriate, the Secretary of State for Transport, have undertaken consultations with local government . . . In the light of consultations with local government, the Secretary of State issued proposals on 1 August 1983 on expenditure guidance, and on 20 October 1983 on relevant current expenditure, aggregate Exchequer grant and grant abatement. He has considered all the representations made to him by local authorities and their associations.

The broad economic background to the settlement is set out in the Chancellor of the Exchequer's statement to Parliament on 17 November 1983, which included the Government's view of the movement in costs in the economy generally. The Secretary of State has taken account of the latest available information on the amount of relevant expenditure by local authorities.

Against this background, in the light of these consultations, and taking account of all relevant considerations, the Secretary of State has determined that the level of local authority relevant expenditure to be taken into account for grant purposes in 1984-85 should be £22,883m . . . This should enable the Government's policies for individual services to be broadly maintained".

The Secretary of State thus made it clear that, after consulting local government, he had set a spending plan for 1984–85 which he wished to see achieved; he also indicated that the Government felt that this plan was attainable, both in aggregate and on a service by service basis.

21. This approach has operated at least since Block Grant was introduced in 1981-82. The system before that was similar. It is thus possible, in theory at least, to examine successive years' Public Expenditure White Papers - in total and by service - to judge how consistent and predictable such plans are for local authorities and thus their likely impact on local resource allocation decisions.
EXHIBIT 3

Precise levels of grant are difficult to forecast, even within the year

TRAFFORD – BLOCK GRANT FOR 1982-83

£m

Source: Fieldwork Interviews, March 1984
There are very severe problems with such an analysis. Some variation from year to year in service expenditure projections is arguably inevitable, as national economic circumstances and priorities shift. Governments use the planning process to manage expectations (e.g. about future wage settlements and level of inflation) and to establish a particular climate - to this extent, PES plans will be expressions of intention and hope rather than forecasts of the future. At the technical level, until the March 1982 White Paper, public expenditure planning was undertaken in 'volume terms' (that is, removing the effects of pay and price changes); and successive years' plans were expressed on different price bases. Since then, spending has been planned in cash. England and Wales were treated jointly from 1981-82 onwards. The definition of current spending used in most tables in the Public Expenditure Survey (PES) White Paper, is different from 'relevant' current expenditure, which is used for Rate Support Grant. In addition, there have been changes of classifications within both PES and RSG current expenditure. It is thus difficult to compare expenditure plans from one year to the next, and even more difficult to compare plans over several years.

Nonetheless the Commission has attempted to make such a comparison since, in the past, many authorities took such plans as the basis for their own planning for one or more future years. The results are discussed below.

22. The White Papers are consistent with Rate Support Grant (RSG) Orders and Reports which precede them. However, there are usually revisions in local government planning totals between the publication of the Public Expenditure White Paper in the early spring and the RSG Settlement announced the following December (some of these changes reflecting changes in policy). For example, the planned total of relevant current expenditure for local authorities in England for 1984–85 was £19.8 billion in the February 1983 White Paper (Cmd 8789), though the figure used in the RSG Report (England) 1984–85 in December 1983 was £20.39 billion. Such variations may seem relatively small in aggregate, given the total sums involved - though in absolute terms, £600 million is not a trivial sum. But successive changes can affect grants at the local level, as Exhibit 3 on page 13 illustrates.

23. Table 3 (below) shows the Government's expenditure plans for local government as a whole in successive White Papers expressed in 1983-84 prices - and assuming that wage and price inflation for 1985-86 and 1986–87 runs at five per cent in each year. The table provides some indication of the predictability of central government's spending plans for local authorities in successive years; and it enables the analyst to speculate as to the reaction of a conscientious authority examining successive expenditure plans.

<table>
<thead>
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<th></th>
<th></th>
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<tbody>
<tr>
<td>Cmd 8175 (Mar 81)</td>
<td>18226</td>
<td>17852</td>
<td>17700</td>
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<td>Cmd 8789 (Feb 83)</td>
<td>19620</td>
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<td>Cmd 9143 (Feb 84)</td>
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<td>18956</td>
<td>18313</td>
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</tr>
</tbody>
</table>

FY 1982 and 1983 figures have been restated to 1984 price levels, as have those for 1985, 1986 and 1987 assuming wage and price inflation of five per cent p.a. The table thus shows that an authority regarding itself as typical

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* Financial Year ending on March 31 in the year shown. Figures for FY 1982 and FY 1985 use Lincolnshire local government price indices as a deflator to convert from cash to 1983-84 prices. Figures for FY 1986 and 1987 use the GDP deflator to convert from cash to 1983-84 prices, because there are no available official projections of changes in local government prices.
which took the 1981 plan seriously would have started off on a spending path leading to a three per cent reduction in real spending within three years. Within a year, however, it would have been apparent that far from a real reduction in spending, government was accepting a 2.7 per cent increase in 1983-84 by comparison with the previous year's plan; and the 1983 White Paper would have confirmed this change, incorporating expenditure for 1983-84 7.6 per cent above 1981-82 levels in real terms and 10.8 per cent above the levels planned only two years earlier. Equally, an authority which decided that the plans were not realistic would have had their views borne out by the upwards revisions of spending figures in successive plans.

24. Thus, as can be seen from the table every year since 1981-82 the Government had added significantly to plans published for future years. The picture that emerges is that since 1973 (and probably well before) governments have made plans for local authorities which are altered from year to year - partly to reflect the response of authorities to the previous plans as well as pay settlements, economic and other policy considerations. But because of the technical problems over appropriate deflators and definitions of expenditure, it is difficult for authorities to draw any reliable conclusions from the published plans. As the Treasurer of a large shire county spending well below GRE reported to his authority's Policy and Budget Group in June 1983: "The currently available information about the Government's intentions for local government spending in 1984–85 is inadequate for providing a firm basis . . . for the county council's budget strategy".

25. This review suggests that the PES expenditure projections are not seen as credible forecasts; neither have they been effective in guiding local authorities' expectations. Indeed, the reaction of many local authorities has been to ignore future years' published expenditure projections, on the grounds that reductions may not materialise as government adjusts to the continued 'overspending' of some authorities, and that the risk of false alarms - for members and staff - is excessive. As the Treasurer of another shire county committed to meeting government expenditure targets put it: "We have been forced to march the troops up the hill [to consider ten per cent expenditure cuts in real terms]; then the new government expenditure figures meant that we had to march them down again. My credibility was so damaged that I will not do it again". In our survey of Chief Executives, we asked a question designed to determine the extent to which government expenditure plans influence local planning; Table 4 (below) summarises the responses.

Table 4: Received importance of PES Plans

<table>
<thead>
<tr>
<th>% Respondents</th>
<th>16</th>
<th>22</th>
<th>24</th>
<th>36</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q: Did the public Expenditure White Paper or RSG report influence the way resources were allocated in 1983-84, and if so to what extent?</td>
<td>Very Important</td>
<td>Quite Important</td>
<td>Some Influence</td>
<td>No Influence</td>
</tr>
</tbody>
</table>

26. In addition to uncertainties about government plans for service expenditure, an individual authority must make its own estimate of the percentage of relevant local government expenditure that will be met from the RSG. This is a greater source of uncertainty for local government than the level of planned service expenditure since it has a more direct effect on local rate levels; and it is one which should be less subject to short-term economic management considerations. As was mentioned earlier, in England this percentage has fallen over the past four years from 60 per cent
to just under 52 per cent. But the rate of the reduction and the future trend is uncertain* - and every percentage point of 'relevant expenditure' is around £230 million more or less for local government, or ±£3 million for a typical shire county.

27. The impact of grant reductions at the local level is considerable. Analysis of the changes between 1982-83 and 1983-84 in grant received and rates levied shows that few authorities increased rates by more than was necessary to compensate for the loss of grants and many levied rates that were lower than would have been needed to keep real spending at 1982-83 levels. Table 5 below shows the position.

Table 5: Changes in Grant and Rates between FY 1983 and FY 1984

<table>
<thead>
<tr>
<th>Grant Change</th>
<th>Larger Authorities</th>
<th>Shire Districts</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt;5%</td>
<td>2</td>
<td>13</td>
</tr>
<tr>
<td>0–5 Reduced</td>
<td>20</td>
<td>17</td>
</tr>
<tr>
<td>Reduced</td>
<td>33</td>
<td>15</td>
</tr>
</tbody>
</table>

If wage and price inflation was running at five per cent in 1983-4 an authority whose grant increased by under five per cent would need to increase rates by more than this in order to compensate for the reduction in grant - for an average authority a nil increase in grant might require a ten per cent increase in rates (unless rate balances were drawn down - and overall, they increased). Thus, it is a reasonable assumption that those authorities in the shaded area of the table (i.e. 75 per cent of larger authorities and 80 per cent of shire districts) increased their rates by less than would have been required to compensate for their loss of grant.

28. The government uses a complex series of formulae to assess, among other things, each authority's need to spend to provide a common level of service. The Block Grant mechanism takes into account both Grant-Related Expenditure assessment and the relative local rateable values per head. GRE was originally intended by Ministers to provide an objective basis on which to distribute rate support grant to individual authorities; and is still regarded in this way by the government**.

29. The intrinsic merits and weaknesses of the GRE approach are discussed later in this report. At this stage, it is important simply to note that GRE is an important element of the Block Grant system, in that an authority's GRE assessment can (and should) affect the grant that it receives. However, the methodology and the data underlying GREs are subject to change and refinement from year-to-year. These changes introduce new uncertainties for authorities. As Table 6 (opposite) shows, even though needs and demographics change relatively slowly there are wide differences in the rates of change in GREs for individual authorities. (Assuming a reasonably stable system, GREs for all authorities would move more or less together, in line).

Unpredictability of Share of Block Grant

* At RSG settlement, Exchequer Assistance for English Authorities as a % of relevant expenditure has moved as follows between 1980–81 and 1984–5: 60.00%, 59.14%, 56.12%, 52.82% and 51.88%. The figure for 1985–6 announced recently is 48.8%.

** cf. paragraphs 3.6 of the Rates White Paper: 'The criteria for selection [for rate limitation] will have particular regard to authorities recent levels of spending and especially how they vary from the objective measure of spending needs represented by the GRE used for distributing the RSG [emphasis added]
Table 6: Changes in GRE in England

<table>
<thead>
<tr>
<th></th>
<th>FY 1982-85</th>
<th></th>
<th>FY 1984-85</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>lowest %</td>
<td>highest %</td>
<td>lowest %</td>
<td>highest %</td>
</tr>
<tr>
<td>London precepting</td>
<td>+19.49</td>
<td>+38.66</td>
<td>+5.79</td>
<td>+9.01</td>
</tr>
<tr>
<td>Inner London</td>
<td>+11.37</td>
<td>+54.17</td>
<td>-2.89</td>
<td>+3.29</td>
</tr>
<tr>
<td>Outer London</td>
<td>+5.26</td>
<td>+31.75</td>
<td>-0.71</td>
<td>+2.98</td>
</tr>
<tr>
<td>Metropolitan Counties</td>
<td>+20.73</td>
<td>+35.60</td>
<td>+5.58</td>
<td>+8.46</td>
</tr>
<tr>
<td>Metropolitan Districts</td>
<td>+4.36</td>
<td>+22.83</td>
<td>-2.19</td>
<td>+5.60</td>
</tr>
<tr>
<td>Shire Counties</td>
<td>+8.40</td>
<td>+22.24</td>
<td>+0.30</td>
<td>+6.97</td>
</tr>
<tr>
<td>Shire Districts</td>
<td>-19.46</td>
<td>+74.85</td>
<td>-17.05</td>
<td>+6.78</td>
</tr>
<tr>
<td>Total</td>
<td>+16.08</td>
<td></td>
<td>+3.37</td>
<td></td>
</tr>
</tbody>
</table>

Even within a county area, relatively large changes in GRE can occur as the following table shows for the districts within County Durham. (The table shows changes in GRE per capita, at RSG settlement).

Table 7: Changes in District GRE's in Durham - FY 1985 vs 1982

<table>
<thead>
<tr>
<th></th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sedgefield</td>
<td>-12.8</td>
</tr>
<tr>
<td>Wear Valley</td>
<td>-3.7</td>
</tr>
<tr>
<td>Easington</td>
<td>-2.4</td>
</tr>
<tr>
<td>Darlington</td>
<td>+8.0</td>
</tr>
<tr>
<td>Chester-le-Street</td>
<td>+8.4</td>
</tr>
<tr>
<td>Derwentside</td>
<td>+24.9</td>
</tr>
<tr>
<td>Durham</td>
<td>+29.7</td>
</tr>
<tr>
<td>Teesdale</td>
<td>+32.5</td>
</tr>
</tbody>
</table>

The changes are largely due to the way surpluses on council housing revenue accounts are treated. However the change was so marked that local members and their officers found it difficult to believe that need to spend could change so markedly over a relatively short period. Despite "safety netting" important uncertainties remain.

Uncertain Spending Targets and Penalties

30. Each year for the past four years, the Government has set individual expenditure targets for each authority. Because the targets were heavily influenced by budgeted expenditure in the previous year, variations in targets are in most cases related to past expenditure. Table 8 (below) shows the extremes involved at the local level.

Table 8: Changes in Expenditure Targets

<table>
<thead>
<tr>
<th></th>
<th>FY 1985 vs 1983</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top Five</td>
<td></td>
</tr>
<tr>
<td>Kingswood</td>
<td>+41.1%</td>
</tr>
<tr>
<td>Mid Devon</td>
<td>29.1</td>
</tr>
<tr>
<td>GLC</td>
<td>26.4</td>
</tr>
<tr>
<td>Windsor &amp; Maidenhead</td>
<td>25.1</td>
</tr>
<tr>
<td>Hackney</td>
<td>25.0</td>
</tr>
<tr>
<td>Bottom Five</td>
<td></td>
</tr>
<tr>
<td>Winchester</td>
<td>-2.9</td>
</tr>
<tr>
<td>East Northants</td>
<td>3.1</td>
</tr>
<tr>
<td>Wokingham</td>
<td>3.3</td>
</tr>
<tr>
<td>Kennet</td>
<td>4.1</td>
</tr>
<tr>
<td>Tewkesbury</td>
<td>5.1</td>
</tr>
</tbody>
</table>

To take just three authorities within London: of these Hackney’s spending target rose by 23 per cent between 1982-83 and 1983-84 and by a further 1.5 per cent between 1983-84 and 1984-85. The comparable figures
for Greenwich were 7.5 and 12.5 and for Redbridge 6.2 and 0. These changes, could not have been predicted by the authority in question at the start of 1981-82. Moreover targets have been established largely independently from the GRE process. Exhibit 4 (opposite) shows the extent of the difference between GRE and targets - in 1984–85 the difference exceeds £10m in 40 authorities.

31. In addition to the changes in targets, the penalty arrangements have also changed - as table 9 (below) indicates, for all authorities spending five per cent or more above target, penalties have increased every year in the past four. This increase is an inevitable feature of the system: as authorities fund the current penalties, there is a risk (as government sees it) of expenditure increasing unless yet more severe penalties are imposed. The regular increase in penalties encourages authorities to incur expenditure earlier than would otherwise be the case - since any penalties that they may incur are likely to be less severe than those in future years.

<table>
<thead>
<tr>
<th>FY</th>
<th>1% Expenditure above Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981</td>
<td>0</td>
</tr>
<tr>
<td>1982</td>
<td>2</td>
</tr>
<tr>
<td>1983</td>
<td>3</td>
</tr>
<tr>
<td>1984</td>
<td>1</td>
</tr>
<tr>
<td>1985</td>
<td>2</td>
</tr>
</tbody>
</table>

The compound effect of targets and penalty arrangements can amount to £ millions for an authority. For example, Exhibit 5 on page 20 shows that in two (industrial) metropolitan districts with similar GREs and rateable values, one authority will receive £40 million in grant and the other zero if both opt to spend at the same level. The main reason is that one authority has a history of high spending and thus a high target; the other has a lower spending tradition.

32. The final grant income for each authority is affected not only by its own spending decisions, but also by the outturn expenditure of the remaining authorities in England. Unexpected developments completely outside the control of the authority in question may adversely affect its grant entitlement. Because the total of grant entitlements is constrained to the total grant available, adjustments to grants are made either during the year or after the end of a particular grant year as more up-to-date information becomes available. This can result in unwelcome surprises for an authority. The case cited most frequently in this review was that of the Greater London Council (GLC). Early in 1984, a forecast of the consequences of the second Rate Support Grant Supplementary Report for 1982-83 was published, showing that the GLC’s estimated outturn total expenditure for 1982-83 was £155m below that in its budget for that year. This reduced level of spending reduced the penalties payable and meant that the GLC was entitled to an extra £100m in Block Grant, which will have to be recovered from other authorities in 1984–85. For some shire counties and metropolitan districts several £ millions were involved. (This was the reason for the last adjustment shown in Exhibit 3 (see page 13)).

33. The close-ended nature of the system could bring other problems. Reduced expenditure by authorities now in penalty would lead to a reduction in Block Grant to other authorities - who are now "benefiting"
The difference between GRE and target can be substantial

DIFFERENCE BETWEEN GRE AND TARGET IN LARGEST AUTHORITIES* - FY 1985

* Counties, Metropolitan Districts and London Boroughs

Source: Audit Commission analysis of information from Cambridgeshire County Council.
Exhibit 5

In many cases, targets reflect prior spending patterns rather than local needs and resources.

GRANT RECEIVABLE AT SAME SPENDING LEVELS - FY 1985

£m
from the spending above threshold of the authorities in question. No financial control system can be effective when performance by one element of an organisation can adversely affect that of another. While the Government's wish to control overall local government expenditure is understandable, the system becomes ineffective — in such circumstances. No commercial enterprise could be successful if it tried to operate on such a basis. Close ending should therefore be reconsidered.

* * * * *

34. Because of the various new uncertainties outlined above, it is not possible for an authority to project its grant income even for the next year with reasonable accuracy; this regrettably continues to be the case. Exhibit 6 (overleaf) shows, in the lower half, two possible grant scenarios for a metropolitan district with a history of low spending relative to GRE; but officers cannot translate this into a defensible projection of grant income and have to rely instead on the relatively crude extrapolations based on previous experience shown in the graph. Since most authorities intend to live within or close to the Government's targets it may be argued that the perceived uncertainties are greater than the reality - though the difference between the least favourable target for 1985-86 and the most favourable is assessed by the Treasurer of one large authority at over £9.5 million, the equivalent of a swing in 'real' expenditure of some 2 per cent. In any case, the psychology is important. The Treasurer of a shire county intends to delay closing the account for 1983-84 for ten weeks "just in case penalty arrangements for 1984–85 change", (as indeed they did).

35. In 1983-84, 227 of the 414 principal authorities in England budgeted to spend within one per cent of the target and only 40 at five per cent or more above targets. Even granted that these targets reflect revised Government expenditure plans for local authorities, such a performance is impressive testimony to local authorities' ability to manage under conditions of uncertainty. Indeed, despite all the problems, most local authorities are following a strategy of seeking to maintain service levels with (if anything) less real expenditure. Table 10 (below) summarises the replies to the question: "how would you characterise your authority's present strategy?".

Table 10: Summary of Local Authority Strategies

<table>
<thead>
<tr>
<th>Q: How would you characterise the present strategy of your authority?</th>
<th>Real Expenditure</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Increase</td>
<td>Maintain</td>
<td>Reduce</td>
</tr>
<tr>
<td>Standards of Expand</td>
<td>6</td>
<td>11</td>
<td>5</td>
</tr>
<tr>
<td>Service Maintain</td>
<td>2</td>
<td>26</td>
<td>47</td>
</tr>
<tr>
<td>Reduce</td>
<td>–</td>
<td>–</td>
<td>2</td>
</tr>
</tbody>
</table>

36. This review suggests that, with the uncertainties described above, this strategy has only proved possible through a series of financial and accounting adjustments. The survey of 186 authorities shows that they have increasingly taken steps to maximise their grant income and to protect themselves against harsher penalties in future years, by maintaining estimated and reported outturn spending levels above that which is strictly necessary to meet current service standards and by creating reserves as a cushion against future increases in penalties and changes in GRE and expenditure targets. This is an entirely understandable response to the
Even near term projections of grant income are hazardous.

TRENDS IN GRANT INCOME: 1980-1986

£m

### POSSIBLE SITUATION NEXT YEAR

<table>
<thead>
<tr>
<th></th>
<th>BEST CASE</th>
<th>WORST CASE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relevant Expenditure vs FY 1985</td>
<td>+ 4.5%</td>
<td>+ 2.0</td>
</tr>
<tr>
<td>RSG Settlement</td>
<td>51%</td>
<td>49.5</td>
</tr>
<tr>
<td>GRE vs FY 1985</td>
<td>+ 5.5%</td>
<td>- 3.0</td>
</tr>
<tr>
<td>Multiplier</td>
<td>1.00</td>
<td></td>
</tr>
<tr>
<td>Target vs FY 1985</td>
<td>+ 8%</td>
<td>+ 2</td>
</tr>
<tr>
<td>Penalties (at Target + 5%)</td>
<td>20 p/£</td>
<td>40</td>
</tr>
<tr>
<td>Wages' Settlement</td>
<td>+ 4.5%</td>
<td>6.5</td>
</tr>
<tr>
<td>'Adjustments' mid-year</td>
<td>-</td>
<td>- 1.5 £m.</td>
</tr>
</tbody>
</table>
kinds of uncertainties referred to by the county Treasurer quoted in paragraph 25, and illustrated in Exhibit 7 overleaf.

37. Authorities often budget to spend over target in order to protect their base spending levels for future years. At the year end, those authorities whose 'real' spending on employees, goods and services is below target increase reported spending by creating special funds and/or making contributions to them and accelerating the repayment of debt. Conversely those authorities who look like overspending against targets are able to reduce spending by rescheduling debt, capitalizing expenditure formerly funded out of revenue and/or charging expenditure to special funds.

38. The scale of the adjustments involved is large. In broad terms, final adjustments on the closing of the 1981-82 accounts saw authorities as a whole increasing their contributions to special funds reserves and balances by some £520 million with the emphasis on increasing Rate Fund Balances. Some increases in balances was no doubt due to the withdrawal of power to levy a supplementary rate, in the Local Government Finance Act 1982. 1982-83 saw a fundamental change. Before the accounts for the year were closed, the penalties for 1983-84 were announced and were much more severe than in 1982-83. This, together with the ability to spend up to target or GRE, created a combination of incentives to carry out a series of adjustments designed to create resources outside the General Rate Fund and to provide the flexibility to allow the authority to pay penalties under a less severe regime. Special funds increased by almost £550 million in that year, with a much more modest increase in Rate Fund Balances (which do not count as expenditure for RSG purposes). These figures do not include any allowance for financing changes. Several of the authorities visited during the in-depth study had decided to repay debt prematurely - sometimes by a large amount, thus increasing reported outturn expenditure.

39. The scale of such adjustments in 1983-84 cannot at this stage be known since local authorities will not complete their accounts until later this year. Early indications suggest that there has been a further net increase of special funds of around £150 million. However, on the assumption that the 'real' underlying base of expenditure incurred in 1982-83 has not grown significantly faster than the general level of inflation and that local authorities close their accounts at or near budgeted levels, the transfers to funds during 1983-84 could turn out to be on a similar scale to the previous year - i.e. of the order of £500m. This conclusion is supported by our findings in the in-depth study set out in paragraph 43 (c) on page 25.

40. These findings indicate that local authorities have responded rapidly, predictably and (from their point of view) sensibly to the pressures induced by the uncertainties referred to above. In an attempt to manage their grant levels and the uncertainty perceived in the grant system, local authorities have built up rate fund balances and accumulated reserves in excess of the level previously regarded as necessary for sound financial management. Table 11, on page 25, summarises the changes that have taken place in 1981-82 and 1982-83 according to the figures provided to us by the Department of the Environment.*

* Replies to the Commission's questionnaire suggest that these figures are, if anything, understated.
Members are now suspicious of forward projections and sceptical of the need for change.

TREASURERS PROJECTED JOB CHANGES IN NEXT 18 MONTHS:
December 1981 — February 1984
Table 11: Changes in Financial reserves

<table>
<thead>
<tr>
<th></th>
<th>Rate Balances</th>
<th>Special Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>London Authorities</td>
<td>171 182</td>
<td>7 62</td>
</tr>
<tr>
<td>Shire Districts</td>
<td>62 (45)</td>
<td>67 122</td>
</tr>
<tr>
<td>Metropolitan Districts</td>
<td>65 (39)</td>
<td>49 92</td>
</tr>
<tr>
<td>Shire Counties</td>
<td>11 (12)</td>
<td>87 186</td>
</tr>
<tr>
<td>Metropolitan Counties</td>
<td>(4) (34)</td>
<td>7 81</td>
</tr>
<tr>
<td>Others</td>
<td>(8) 21</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>297 73</td>
<td>217 543</td>
</tr>
</tbody>
</table>

These figures are in marked contrast with those for the previous three years, when the corresponding financial reserves reduced overall by about £200m. Exhibit 8 (overleaf) shows the abrupt increase in net contributions to special funds that followed the introduction of targets and penalties in 1981-82. In March 1983, authorities' reserves amounted to 11.4 per cent of rate and grant borne expenditure in the year, compared with 7.7 per cent two years earlier - an increase of almost a half. The solid line shows total contributions to both capital and revenue funds for England and Wales. The dotted line contributions to revenue special funds in English Authorities only. Contributions to special funds can be regarded as a response to year to year uncertainties whilst balances probably reflect those due to cash flow fluctuations.

41. It appears that growth in balances and reserves has been highest where the perceived uncertainty as to future grants and the impact of penalties is greatest, in London and at the shire district level where penalties and the unpredictability of housing GRE have the greatest effect; and they are lowest in shire counties where there has been less uncertainty, because GREs and targets have been relatively predictable. Since the build up of these funds and balances is a hedge against future "hard times" it is probable they will eventually be drawn down - when either conditions become more certain and/or the costs of holding them make it no longer worthwhile, or as a means of avoiding penalties.

42. The existence of excess rate balances and the increased contributions to special funds can (and are) argued by Treasurers to be in their authorities' interests. They earn interest of course; and they serve to avoid possible future penalties that are seen as likely to be harsher than those now in place. What seems beyond dispute is that local rates in the year in question have been higher in consequence of these steps.

43. Moreover, because of the distortions that have been introduced into reported expenditure by the adjustments discussed above, local authority budgets are no longer a reliable indication of authorities' planned level of spending. The government is thus planning next year's RSG settlement on misleading information. Even at outturn, which follows some 15 to 18 months after the RSG settlement, there is no firm indication of the "true" level of local government spending. Our fieldwork suggests the scale of the problem:

(a) five out of 16 authorities had prematurely repaid debt in order to create future flexibility and to attract more grant;
(b) the level of capital financing charges has been further obscured by a variety of accounting changes;
(c) many budgets are now presented as showing large sums being taken out of Special Funds whereas the outturn is consistently and significantly different as table 12 on page 27 shows.
Contributions to Special Funds rose sharply in FY 1982 and 1983

**NET CONTRIBUTIONS TO SPECIAL FUNDS**
**FY 1975-1983**

£m

*Source: Audit Commission analysis*

— Contributions to both Revenue and Capital Special Funds (England and Wales).
— — — Contributions to Revenue Special Funds only (England).

* Estimate
Table 12: Changes in Special Funds in Fieldwork Authorities

<table>
<thead>
<tr>
<th></th>
<th>Budget</th>
<th>Actual</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>1982-83</td>
<td>3.3</td>
<td>36.1</td>
<td>32.8</td>
</tr>
<tr>
<td>1983-84</td>
<td>(11.9)</td>
<td>31.9</td>
<td>43.8</td>
</tr>
</tbody>
</table>

The actual figure for 1983-84 was estimated on the basis of plans made in early 1984. The outturn is likely to be higher, since five of the 16 authorities had still to declare their intentions.

(d) Expenditure from special funds is not being shown in some local authority budgets on the grounds that plans have not been finalised.

44. Exhibit 9 (overleaf) sets the accounting adjustments described above in the overall context of total "overspending" by local authorities against the government's expenditure targets. It shows that what might be termed "excess" service expenditure has fallen sharply in the last three years - to the point where last year, depending on the eventual level of net contributions to special funds, there may have been little, if any, overspending on services. The figures make no allowance for premature retirement of debt or for other changes in financing, both of which would have the effect of reducing reported service expenditure further. Even on optimistic (i.e. low) assumptions about contributions, excess expenditure last year would have been under 2 per cent of the total.

* * *

45. In summary, the Commission recognises why targets and penalties were introduced; and, as the Exhibit shows, aggregate local authority spending is now close to the target. General use of targets and penalties has brought additional uncertainties for members and their officers to take into account when planning more than a year ahead. In the main they have responded rationally to these uncertainties by seeking to create a financial cushion against them. The result has been that rates over the past three years have probably been higher than they need, by some £400m a year. Longer term planning has remained in abeyance in many authorities, - despite the necessity of a strategic perspective referred to earlier. And the true level of local government expenditure has been obscured.

46. As the Commission sees it, local authorities have responded to the uncertainties inherent in the present grant distribution arrangements in an entirely understandable and predictable way. The unintended effects of this response can best be avoided by reducing the level of uncertainty rather than by seeking to impose tighter central control, for instance. The following steps seem worth detailed evaluation: providing local government with a three year projection of the cash support to be made available under the Aggregate Exchequer Grant (or at least some indication of the percentage of planned service expenditure to be met from AEG) as part of the Public Expenditure Planning process; stabilising the penalty arrangements - if these are to remain; and eliminating the need for some of the grant adjustments after the beginning of the financial year. Such changes would make it easier for authorities to adopt a longer-term strategic perspective and they would make the system more flexible and easier to understand - thus enhancing local accountability. In addition, grant could be distributed by reference to the GRE for each authority provided that the calculations are much more robust than is now the case. The Commission takes no view on the question of whether targets separate from GRE should be retained for any particular authorities. The weaknesses in the present GRE calculations are the subject of the next chapter of this report.
Exhibit 9

Overall Local Authority service expenditure in 1983-4 was probably within ½-2% of government targets.

'EXCESS' SPENDING RELATED TO INCREASES IN LOCAL AUTHORITY RESERVES

Notes: (i) 'Reported excess' spending is the difference between Government plans - as set out in the relevant RSG Reports – and outturn (as for 1983–4, revised estimates).
(ii) Changes in Rate Balances do not count in 'total' expenditure for Block Grant purposes and are thus shown separately to the 'reported excess'.
(iii) Net contributions to Special Funds do count as part of the 'total' expenditure and are shown as part of the 'reported excess'.
(iv) 'Adjusted excess' is 'reported excess' minus net contributions to Special Funds.
2 The impact on a potentially sound approach to grant distribution

47. An effective system for distributing central government grants to local authorities should ensure that these are distributed in line with each council's need for support - taking into account its own resources, the services for which it is statutorily responsible as well as the local demographic and socio-economic conditions. The Grant-Related Expenditure assessment is designed to achieve these two last objectives. The most recent Rate Support Grant report describes GREs as a "key determinant" of an authority's Block Grant entitlement and explains that "in order to achieve the equalisation of needs between authorities, grant is distributed with reference to an assessment of the cost to each authority of providing a common standard of service, allowing for differences in the characteristics and needs of the different areas: That assessment is known as the grant-related expenditure (GRE)".

48. The Department of the Environment (DOE) has made it clear to the Commission that GREs are not prescriptive, and that government has not suggested that every authority ought to spend at its GRE; and many local authorities have only accepted GREs as a basis for grant distribution, without conceding that they should limit authorities' ability to spend above GRE if local circumstances warrant.

49. The system holds the potential for providing a rational basis on which to distribute Block Grant to authorities; and our fieldwork suggests that this potential is widely acknowledged within local government. Moreover, circumstantial evidence at least indicates that government also regards the GREs as the best available means of determining authorities' need for grant support, although there is evidently some confusion between the use of GRE to distribute grant and its use as an indicator of appropriate overall expenditure by an authority. For example, in the recent past GREs have been used for a wide variety of not always mutually compatible purposes:

(a) GREs were described as "an objective measure of spending needs" in the White Paper Rates, published in August, 1983;
(b) GREs have been used in part in the setting of expenditure targets - even though other factors such as past expenditure levels have also been taken into account;
(c) GREs have been used to discourage authorities from pre-empting an unreasonable share of Block Grant by setting a threshold 10 per cent above GRE beyond which authorities receive a lower level of grant support on additional expenditure;
(d) The Secretary of State has stated that GRE would be a likely determinant of whether an authority should have its rates limited under the Rates Act 1984. An authority spending more than a set percentage above GRE will be likely to fall within the rate limitation scheme.
(e) The 1984 Public Expenditure White Paper (page 131 of Volume II) explains the difference between allocated and unallocated current spending as reflecting the likelihood "that some authorities will not
be able to reduce their spending to levels that government considers desirable”. Allocated expenditure is the basis of GREs.

(f) Block Grant fulfils an important equalisation objective. This is done by setting a rate poundage which is the same for every authority of the same class if it spends at GRE.

50. The Commission considers that the basic concepts underlying the Block Grant system - determining relative need for services by reference to population, demographic and social information rather than in accordance with past expenditure patterns - are sound. It could provide the means for distributing grant in a way that is clear, consistent, understandable and fair. However the evidence of this review suggests that the approach is being weakened by:

(i) Superimposing targets, which have assumed greater importance than GRE for most authorities;

(ii) Some unresolved questions about elements of the GRE calculations;

(iii) Inadequacies in some of the basic data on both local needs and resources;

(iv) The sheer complexities involved.

51. Because an expenditure control system has been grafted on to a system for distributing grant, it is possible for authorities to have targets that differ from GRE. Since targets affect the level of grant received, some authorities will not be receiving the grant which local needs (as assessed by GRE) warrant. As a result their effectiveness in meeting those needs will inevitably be impaired. At the same time, other authorities may be receiving more grant than might be justified by local needs. The differences between GRE and targets also mean that the original equalisation objective in paragraph 49 (f) above is compromised.

We have already shown that most authorities plan to spend at or near targets. Chief Executives report a steadily increasing emphasis on minimising penalties, maximising grant income and spending at target as Table 13 (below) indicates.

| Q: How has the time spent by the senior management team on the following activities changed since the introduction of block grant? |
|-----------------|--------|--------|--------|--------|
| Minimise Grant Penalty       | 37     | 40     | 65     | 72     |
| Maximise Grant Income        | 33     | 40     | 56     | 56     |
| Spend at Target              | 38     | 43     | 60     | 66     |

52. As was intended when they were introduced targets have become the dominant influence on authorities' overall spending levels. The difference between targets and GREs is not trivial as we showed earlier (Paragraph 30, page 17). Since targets reflect previous expenditure patterns, authorities with similar needs (as assessed by GRE) will often have different targets - thus further undermining the credibility and importance attached to GREs by members and officers within local government.

53. In aggregate terms, if all authorities spent at target, over £600m would be spent in excess of GRE even though some authorities will underspend GRE. This is already recognised in the Public Expenditure White Paper. Table 14 opposite summarises the figures by class of authority.
The table understates the difference in spending between GRE and targets since the figures include authorities where the target is below GRE - as is the case with four London boroughs, 13 metropolitan districts, 158 shire districts. If authorities with targets below GRE are excluded, the targets are over £1 billion in total above the sum of GREs. Grant accounts for some 40 per cent of the typical authority's expenditure. So, if the GREs are indeed a sound indicator of authorities' need for grant support, on this basis perhaps as much as £400 million a year of grant could be said to be misdirected in the sense that it is either being withheld from authorities which (based on GRE) appear to warrant extra grant; or it is being applied in authorities which have already received their "fair" (GRE-implied) share of the total grant available. In addition, the differences between target and GRE compromise the equalisation objective. For both these reasons, it would be expected that the gap between GRE and targets should narrow over time. However, as Exhibit 10 (overleaf) shows, the gap is widening; and a higher proportion of authorities have targets two per cent or more above GRE, than was the case two years earlier.

54. Since penalties are designed to deter higher spending even by authorities with expenditure below GRE, some authorities will receive no grant, even if they spend at GRE - thus further reducing confidence in the GRE approach itself. The starkest example of this in 1984-85 is West Sussex County Council. If Block Grant operated without targets and penalties, West Sussex would receive a grant of £60.9 million for spending at GRE. But because West Sussex has a target below GRE (reflecting its past relatively low expenditure) penalties would remove the whole of the £60.9 million Block Grant before spending reached GRE. Similarly 72 non-metropolitan districts would lose all their Block Grant for spending at GRE. In 1984-85 Dudley, Berkshire and East Sussex would each lose more than 50 per cent of their block grant when spending at GRE level.

55. The use of targets which differ from GREs, while confusing, may be attributable to the Government's wish to "rein in" aggregate expenditure, and to balance fairness to previously compliant authorities with the need to bring down - at least to some extent - spending by all authorities. But targets and penalties have also had the unintended effect at the local level of distracting attention away from GREs and from planning how longer-term needs can be met while reinforcing a short-term perspective among members and officers alike.

56. Part of the reason for the difference between GREs and targets shown in Table 14 (above) may be that there are problems in the basis on which GREs have been calculated. The significance of the grant distribution process has been increased by the introduction of penalties for spending over target - and of course by the prospect of rate-capping. So while authorities could reasonably have been expected to accept some element of "rough justice" in a system designed just to distribute central government grants, a more refined approach may be required where the
Exhibit 10

The gap between targets and GREs is now widening
TARGETS IN RELATION TO GRE IN ENGLISH AUTHORITIES

No. of Authorities

Source: Audit Commission Analysis
consequences of relatively small changes in the grant distribution mechanism are magnified at the local level.

57. Of course, any system for distributing grant will be open to question; and it would be naïve to pretend that the process can ever be without its critics or those seeking to manipulate the system to the advantage of their authority or interest group. However, even though they are subject to annual review, it is evident from our fieldwork and completed questionnaires that some elements within the GRE calculations are still generally viewed within local government with a suspicion that seems to go beyond what might be regarded as "normal" special pleading. The following concerns merit more detailed examination than was possible in the context of this review. At minimum, the continuing concerns demonstrate that the increased complexity inherent in the present GRE approach has not resulted in a general perception of fairness - and it calls in question the advisability of undue reliance on GREs in their current form.

(a) **The GRE for education.** Education accounts for well over half the total expenditure in the relevant authorities. The GRE formula assumes that school places can be reduced in line with school rolls, with a 21-month time lag. This is regarded as unrealistic by many rural authorities and those with rapidly falling rolls - especially where secondary schools are concerned, given the protracted timetable for statutory consultation and the inevitable difficulties in "carrying" any reorganisation proposals through the communities affected by them. It is also argued to be inconsistent with the Department of Education and Science's apparent endorsement (in circular 2/81) of local authority plans to reduce the number of surplus places in secondary schools by 40 per cent (only) of the estimated surplus during the next decade. To the extent that the timescale involved is unrealistic, the present GRE formula discriminates in favour of those non-rural education authorities where the fall in rolls is limited. The difference could easily amount to £2-3 million in GRE for every year of "slippage" in rationalising education provision in an authority with rapidly falling rolls.

(b) **GRE Allowances for Debt Charges.** The present arrangements for dealing with debt charges are open to question, in that they appear to discriminate against areas with special needs: in areas where population has declined, debt charges (which account for some 22 per cent of net local government expenditure) bear increasingly heavily on the population left behind; in areas where population has increased additional capital spending is often necessary again giving rise to higher than normal debt charges. Moreover, GREs which are largely population based such as those used for parks and libraries are likely to disadvantage such authorities, at least in the short term. Park acreage or book stock and library staff cannot readily be reduced directly in line with changes in the population. The problem is likely to be particularly serious in cities such as those shown in Table 15, on page 35, which have retained some 'regional' functions despite significant population shifts.

(c) **Housing.** The GRE for council housing is based on a complex formula that estimates the deficit that each authority could expect in its Housing Revenue Account (HRA), allowing for the size and nature of its housing stock. Only a minority of authorities now subsidise their HRA; while, as Exhibit 11 (overleaf) shows, 75 authorities generate a surplus from their HRA to benefit their rate fund. The main factor distinguishing authorities in a surplus position is not that they charge above average rents, or manage with below
Exhibit 11

Some authorities make a surplus on Housing Revenue Account, even though GRE assumes break-even

**RATE FUND CONTRIBUTIONS TO HOUSING REVENUE ACCOUNT**

£ per House, 1983/84 Estimates

* Excluding contributions connected with housing benefit

*Source: Audit Commission analysis of CIPFA Statistics*
average repairs and other costs. It is simply that they generally have relatively low historical capital costs (as measured by the level of debt charges less interest receipts per house). The GRE formula allows for this factor.

But for all authorities where the resulting assessment would be negative, the actual housing GRE is set at zero. Thus, even though such authorities would be expected to earn a surplus on their HRA, their Block Grant is set on the assumption that they simply break even. This "zero-ising" of the housing GRE appears to be at variance with the stated objectives of the GRE system. It means that some 40 housing authorities with an annual surplus of £100,000 a year or more on HRA are receiving grant as though they were not making this surplus. One authority has an annual HRA surplus of over £3.5 million; and 15 have surpluses of £400,000 a year or more. Quite apart from the question of fairness, the present arrangement is likely to work against the government's policies towards public sector housing, in that it tends to blunt the incentive on such authorities to charge normal rents and to economise on repair and management expenses.

(d) Inner City authorities argue that the system does not allow sufficiently for the compounding effects of the concentration of different problems in Inner Cities. For example, there are some areas where there is a combination of relatively high levels of male unemployment, poor housing, children in care, single parent families and elderly people lacking local networks of social and family support and children with educational difficulties.

(e) Social Services. Following the 1974 reorganisation of the National Health Service, local authorities became responsible for the hospital social workers in their area. Authorities which happened to have large teaching hospitals or specialised hospitals within their area carry a disproportionate share of the costs. For example

- in Manchester, 47 per cent of the City's social work budget is devoted to hospital social work but some 55 per cent of the patients were last year normally resident outside the City
- Great Ormond Street hospital group has 27 hospital social workers paid for by the London Borough of Camden, although only 3 per cent of the patients come from the borough. When Camden estimated the extra cost arising from Great Ormond Street, it was assessed at £750,000 a year.

(f) Use of Multiple Regressions. Variations in local unit costs for refuse collection and disposal, as well as planning control and differences between GREs on the one hand, and the Home Office's views on

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Manchester</td>
<td>-18</td>
<td>-13</td>
</tr>
<tr>
<td>Liverpool</td>
<td>-16</td>
<td>-16.5</td>
</tr>
<tr>
<td>Newcastle</td>
<td>-11</td>
<td>-9.5</td>
</tr>
<tr>
<td>Inner London</td>
<td>±8</td>
<td>-17.5</td>
</tr>
<tr>
<td>Birmingham</td>
<td>-8</td>
<td>-11</td>
</tr>
<tr>
<td>Sheffield</td>
<td>-6</td>
<td>-10</td>
</tr>
<tr>
<td>Outer London</td>
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<tr>
<td>Leeds</td>
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<td>-7</td>
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<tr>
<td>Other Metropolitan Districts</td>
<td>-2</td>
<td>-7.5</td>
</tr>
<tr>
<td>Shire Counties</td>
<td>+6</td>
<td>-4.0</td>
</tr>
</tbody>
</table>

Table 15: Population changes %

...
local establishment levels for police and fire services on the other,
indicate that the reservations about the use of multiple regression to
derive GREs for their services could be well founded. Despite the
Government's general wish to avoid the use of multiple regression
 techniques - analysing past expenditure against a range of socio-economic indicators to determine "need", 17 per cent of GRE (over
£3.2 billion) is still allocated on this basis. Table 16 below summarises
the services involved.

<table>
<thead>
<tr>
<th>Service</th>
<th>GRE (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Police - maintenance of the peace</td>
<td>777</td>
</tr>
<tr>
<td>Probation and after-care</td>
<td>29</td>
</tr>
<tr>
<td>Magistrates Courts</td>
<td>28</td>
</tr>
<tr>
<td>Fire</td>
<td>482</td>
</tr>
<tr>
<td>Refuse Disposal</td>
<td>170</td>
</tr>
<tr>
<td>Planning Control</td>
<td>204</td>
</tr>
<tr>
<td>Environmental Health</td>
<td>315</td>
</tr>
<tr>
<td>Refuse Collection</td>
<td>428</td>
</tr>
<tr>
<td>Parks, Open Spaces and Parishes</td>
<td>358</td>
</tr>
<tr>
<td>Sports &amp; Recreation</td>
<td>289</td>
</tr>
<tr>
<td>Rate Collection</td>
<td>158</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>3,238</strong></td>
</tr>
</tbody>
</table>

(g) **Other Anomalies.** Several other apparent anomalies have been
pointed out in the course of this review which are worth recording,
since they call in question the credibility of the GRE methodology as
it has evolved so far

- assumed levels of spending on concessionary fares do not reflect
  the availability of public transport locally, or car ownership; thus,
  the assumed subsidy per capita in Manchester, which is heavily
  dependent on public transport, is the same as that in rural areas
  where the public transport infrastructure is much more restricted
  (the apparent anomaly may have arisen because transport subsidies were seen as a means of channelling central grant support to
  disadvantaged rural areas).

- GREs for museums are based not on the present facilities but on a
  proxy for possible demand (in this case, area of local shopping
  space).

- GREs in London make limited allowance for the impact of tourism
  and commuters on authorities' costs. In other tourist areas such as
  East Anglia, the Cotswolds and the South West no allowance is
  made for day trippers. Some of the local authorities concerned
  argue that the costs of libraries, parks, leisure facilities and refuse
  collection are all influenced by the impact of tourists.

58. It is inevitable that criticism will be made of any formula-based
allocation process by those authorities who are not satisfied with the
outcome. Moreover, dealing with these questions may introduce yet more
complexity - an issue referred to below. However, the existence of these
questions is tending to distract the attention of local managers from the
need to redeploy resources to meet new needs and demands; and it
encourages an unhealthy preoccupation with the grant distribution arrange-
ments. The existence of so many unresolved questions after four years
experience of operating the Block Grant system also casts some doubt upon
the use of GREs for any purpose other than grant distribution. And, it is
evident that complexity has not, so far, produced a general perception of
 equity.

* Via: visitor nights as estimated by the Secretary of State on the basis of long-distance travel surveys
and day time net inflows, based on 1971 (sic) census for 1984–85.
59. If GREs are to provide a sound basis for distributing grant, they must be based on reasonably accurate and up-to-date information. If they are not so based, grant will be mis-allocated - with inevitable consequences for authorities' economy, efficiency and effectiveness. For instance, an authority that receives less grant than it might "normally" be entitled to, may not be able to provide the services that local circumstances warrant; by contrast, an authority in the reverse position may be less motivated to secure economy and efficiency, since weaknesses in management could be masked by a higher grant than would be justified by the local situation.

60. Unfortunately, the information used to calculate both the needs for local authority services and the availability of local resources is open to serious question.

61. Specifically, information on resident population is often inadequate and/or out of date. The results of the 1981 census showed that previous estimates of population made by the Office of Population Censuses and Surveys (and used by DOE) were often in error, in some cases, by as much as ten per cent. This has unfortunate consequences:

(a) Since around one-third of GREs are population-based there are abrupt changes in grant - sometimes by £ millions - when the census results become known. This inevitably complicates the local management task and introduces another source of uncertainty.

(b) For the personal social services generally, which account for some 8.5 per cent of (gross) local authority resources expenditure or approaching £2.5 billion a year, the available data on many potential needs groups is inadequate; and without accurate local information about (for example) the number of elderly people living alone, the number of single parent families and so forth it is not possible to determine the local need for social services with reasonable accuracy*.

(c) The problem is especially serious in Inner City areas, where social deprivation needs tend to be concentrated and for suburban areas like Woking, for instance, where the population is increasing at a relatively fast pace.

62. The problem is not confined to Block Grant calculations. The information on which Housing Investment Programme (HIP) Allocations are distributed is also questionable. Every year, in the late Autumn, each of the 401 local authorities in England and Wales responsible for housing receives a capital expenditure allocation for the ensuing year. The allocation, is very detailed (i.e. to the nearest £'000's - or one twentieth of a house); and is based on Ministerial discretion and the Generalised Capital Need Index (GNI). This in turn is based on information that will be at least four years old (one of the factors is based on data from a survey carried out in 1977); and the two most important factors - covering dwellings in poor condition and accounting for 50 per cent of the GNI - are derived from the results of the English Housing Conditions Survey which might cover ten houses in an average authority.

63. In addition, the way in which local resources are assessed for grant distribution purposes means that serious distortions are introduced into grant allocations unless rateable values are a realistic reflection of local needs.

* Since caring for a particularly disturbed child can cost £10,000 or more a year, inaccurate information can have very serious financial consequences for individual authorities.
Exhibit 12

Local rateable values are a key determinant of grant

THREE NORTHERN METROPOLITAN DISTRICTS

Block grants as % GRE *

* at Budget, after allowances for penalties

Source: Audit Commission Analysis, of information supplied by Cambridgeshire County Council, April 1984
property values. An authority's entitlement to Block Grant is assessed, among other things, by taking account of its relative rateable value. Grant receivable by a council with low rateable values can be several £ millions higher than that received by an authority with high rateable values all other factors being equal. Within metropolitan districts, grant receivable (at target) varies from under 28 per cent of GRE in an authority with high recorded rateable values like Trafford to almost 65 per cent in authorities like Bradford with low rateable values. Exhibit 12 (opposite) illustrates the phenomenon. The three authorities shown are very similar in every respect except rateable value. It is therefore central to the perceived fairness of the system - as well as to the stated equalisation objective - that rateable values should represent a sound measure of local property values.

64. Unfortunately, this is no longer the case. There has been no rating revaluation since 1973; and property values have changed significantly in the last decade. As Exhibit 13 overleaf indicates, these changes have not been at a constant rate across the country. Moreover, improvements to domestic properties resulting in a change of less than £30 rateable value are ignored between revaluations - even though the past decade has seen more domestic modernisation and improvement than ever. In addition, there are frequently long delays - sometimes of five years or more - in adjusting rateable values of factories that have been reduced in size but not demolished. One Northern industrial city has lost £600,000 in grant foregone since 1981 while an appeal against the rateable value of a local company's property was decided. (The case had been in progress for nearly a decade).

65. The White Paper in December 1981, Alternatives to Domestic Rates (Cmnd 8449) stated that there was an urgent need to revalue non-domestic properties. This same report speculated that a revaluation would result in the following shifts:

(a) larger, older labour intensive industries in the Midlands and the North would have their relative rate burdens substantially reduced - Authority B in Exhibit 12 opposite is an example of an area where the (heavy electrical engineering) industrial base has declined since the early 1970s;

(b) newer steelworks, local shops and older offices would receive a slight reduction;

(c) new offices and small factories on modern industrial estates would be slightly increased;

(d) shops in primary locations and modern oil refineries would be substantially increased.

66. According to the White Paper on Rates published last August the government has decided that non-domestic property will be revalued shortly. But the same White Paper stated that an independent revaluation of domestic rateable values could not take effect before the end of the decade; so in the meantime rateable values of domestic property are to be adjusted pro-rata to changes in commercial and industrial property values.* Exhibit 14 on page 41 shows some of the existing relationships between prime office rents and rateable values.

67. However, several commentators have criticised the validity of the 1973 valuations which maintained regional differences in rateable values substantially greater than variations in average property values (for instance). Comparisons of rateable values for standard house types provide

* cf. Rates (Cmnd 9008) paragraph 5.9: "The Secretary of State will therefore make an order adjusting the rateable values of either revalued or non-revalued properties so as to preserve the present ratio between the aggregate values of the two sectors".

39
Exhibit 13

Property values have not changed at the same rate,

CHANGES IN PRIME OFFICE RENTS: 1980-1984

£'s per square foot

ILLUSTRATIVE

<table>
<thead>
<tr>
<th>City</th>
<th>Rate</th>
<th>£'s per capita 1984</th>
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</thead>
<tbody>
<tr>
<td>BRISTOL</td>
<td>+60%</td>
<td>£145</td>
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<tr>
<td>MANCHESTER</td>
<td>53</td>
<td>200</td>
</tr>
<tr>
<td>NOTTINGHAM</td>
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<td>149</td>
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<tr>
<td>SWINDON</td>
<td>43</td>
<td>141</td>
</tr>
<tr>
<td>CITY OF LONDON</td>
<td>41</td>
<td>n/a</td>
</tr>
<tr>
<td>SOUTHAMPTON</td>
<td>36</td>
<td>150</td>
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<td>LEICESTER</td>
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<td>149</td>
</tr>
<tr>
<td>WESTMINSTER</td>
<td>25</td>
<td>1,500</td>
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<td>KENSINGTON</td>
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<td>NORWICH</td>
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<td>READING</td>
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<td>LAMBETH</td>
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<tr>
<td>LIVERPOOL</td>
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<td>133</td>
</tr>
<tr>
<td>BRADFORD</td>
<td>0</td>
<td>95</td>
</tr>
</tbody>
</table>

Source: Audit Commission analysis of information from Cambridgeshire County Council and Debenham, Tewson and Chinnocks Chartered Surveyors
Since the early 1970's, the relationship between rateable values and rental leases has shifted

COMPARISON OF PRIME OFFICE RENTS AND RATEABLE VALUES OUTSIDE LONDON

Spring 1984

Source: Audit Commission Analysis, Debenham, Tewson and Chinnocks, Chartered Surveyors
some startling and apparently anomalous contrasts at the local level. For example, in outer London values in Haringey are 40 per cent above those in Bexley; in Sheffield they are 25 per cent higher than in Barnsley; in Leeds 22 per cent higher than in Kirklees; in Elmbridge (Surrey) they are more than 130 per cent higher than in Tonbridge in Kent; and in Scunthorpe (Humberside) rateable values for the same house type are 40 per cent higher than they are in Easington in Durham. It does not seem plausible that local property values vary so widely.

68. Partly because of these anomalies, rateable values in London have been discounted for Block Grant distribution purposes. But this simply gives rise to further anomalies. There are eight non-metropolitan districts outside London with rateable values per capita of £170 or more who do not enjoy the discounted rateable values; and a similar number of London boroughs with rateable values below £170 a head who do benefit from the discount.

69. The continued use of inadequate information about local property values inevitably introduces serious distortions to the grant distribution process. Parliament is voting Block Grant on the assumption that part of the vote serves to compensate for some of the differences in local resources. Indeed, for disadvantaged areas the equalisation element within Block Grant is one of the benefits of being part of a unitary state. But this objective is compromised by shortcomings in the basic data. Table 17 below illustrates the scale of the distortions that could have been introduced in the last four years alone to grants received by three different metropolitan districts - assuming, for purposes of the illustration, that domestic property values have moved in line with prime commercial rents.

Table 17: Illustration of the possible impact on grant of changing property values - FY 1985

<table>
<thead>
<tr>
<th>Authority</th>
<th>Rateable Value</th>
<th>Adjusted Rateable Value</th>
<th>Grant Receivable (at target)</th>
<th>Difference in grant (2)–(1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>194</td>
<td>75</td>
<td>89</td>
<td>46</td>
</tr>
<tr>
<td>B</td>
<td>181</td>
<td>66</td>
<td>97</td>
<td>112</td>
</tr>
<tr>
<td>C</td>
<td>198</td>
<td>68</td>
<td>115</td>
<td>141</td>
</tr>
</tbody>
</table>

On this illustrative basis, the total rates bill in City C above would be reduced by perhaps as much as one-third, and in City B by over 15 per cent.

70. In view of the amount of public money involved and the importance to the perceived fairness of the grant distribution process - as well as to local economy, efficiency and effectiveness - of sound information on needs and resources, it is vital that the weaknesses described above be corrected. At present there is too much fine-tuning by computers of inadequate basic data, resulting in spurious accuracy. The case for a mid-term census - perhaps on a selective basis, concentrating on particular indicators of social need and local housing conditions, and on localities where population changes are most likely to be significant - appears strong. It is difficult to see how rateable values as now assessed can be regarded as a sufficiently reliable and up-to-date indicator of local resources; so an alternative source of information on local property values is required for grant distribution purposes, even though for the time being domestic rateable values may have to continue to be used as a basis for calculating individual householders’ rate liabilities.

* Adjusted as per Exhibit 12.
71. The present grant system is the product of simultaneous desires for simplicity and equity; and it is the product of a deal negotiated between government and different local authority interests. Both the last two desires increase complexity. So long as they are stronger than the desire for simplicity, it is unrealistic to expect any worthwhile process towards a more understandable grant distribution system.

72. But, it is difficult to avoid the conclusion that the complexity of the GRE system undermines the confidence of members and officers in it. The task of distributing £8.6 billion of grant to authorities in line with their relative need for local services and in such a way as to compensate, so far as is possible, for differences in local rateable values has now become a small industry in itself. Many officials, both within government departments and in local authorities are involved in making the system work. Officers from over 50 different authorities participate directly in the different working groups associated with the GRE system; and responses to our questionnaire suggest that within local government alone there is the full time equivalent of over 800 people engaged in operating the system.

73. In our discussions with members and officers, there is a recurring theme that the system for distributing government grants is now so convoluted that many have abandoned the attempt to understand it fully, still less to explain the implications to their colleagues on the council or to voters. That the complexity is introduced often in response to pressure from local authority interests - and despite the stated objective of making the system more understandable to the layman - is little comfort.

74. The complexities involved are considerable, as the appendix demonstrates. Even the language used is difficult to understand. For instance, it is unlikely that too many people who heard the following statement in the Welsh Rate Support Grant announcement in Parliament understood it; and the meaning is not exactly clear and unambiguous to experts in the field.

"The Block Grant mechanisms for the 1984–85 settlement will remain the same as those for the current year, which are as follows:

(i) The slope of the grant related poundage (GRP) schedule below the threshold is 1.75 per cent for every one per cent change in expenditure relative to GRE;
(ii) The threshold remains at ten per cent;
(iii) The power of the curve of the poundage schedule above this threshold is 1.75;
(iv) There will be a one stage safety net which will set a limit of 5p in the pound at the ratepayer level on the poundage effect of changes in GRE assessments and the continuing effects of the change in the basis of equalisation. The safety net will not protect ratepayers from the effects of changes in the GRP schedules nor from the individual authorities' expenditure decisions. The safety net for counties will be 4p and that for districts 1p, which broadly reflects their share of aggregate GRE."

Similarly, Annex L of the Rate Support Grant (England) 1983-84 described the arrangements for London thus:

"Grant-related expenditure (GRE) will be determined for London authorities on the same basis as for other authorities (except in the case of the Metropolitan Police; see paragraphs 5 to 7 of this Annex). Multipliers will be determined under Section 59 (b) (b) of the 1980 Act which will allow London as a whole to retain some of the resource advantage implied by its high aggregate rateable resources, and which will at the same time have the effect of redistributing some of that advantage between inner and outer London. The effect of these
adjustments can be represented as a "poundage discount".

75. Unnecessary complexity does not help local authorities or govern-
ment to solve the many difficult issues bound up with grant allocation. On
the contrary, it blurs accountability, encourages members and officers to
seek to "play the system" and takes up the time of many senior financial
officers to no good purpose. There is always likely to be some trade-off
between simplicity and fairness in the grant distribution system. However,
the Commission does not accept that the present level of complexity is
inevitable and that simplification must reduce the perceived "fairness" of
the system.

* * *

76. There appears to be general support within local authorities in
England for the basic principles which underline the GRE approach to
distribution of Block Grant. And the Commission believes that GREs
could indeed provide the basis for a system that is clear, consistent,
understandable and fair. However, the confidence of many within local
government in the GRE approach and the Block Grant system is being
eroded because of the distorting effect of targets and penalties, the
unresolved methodological questions with some GRE elements, inadequate
information on local needs and resources and by the sheer complexity of
some of the calculations. Together these weaknesses reduce some local
authorities' drive for efficiency and prejudice the effectiveness of others
because of the distortions they introduce into grant distribution.

77. Restoring confidence will require steps along the following lines:
strengthening the current efforts to simplify the system; a selective
mid-term census to provide more reliable information on local needs for
services; and a new basis for assessing local property values since
out-of-date rateable values are too crude a measure for grant distribution
purposes.
3 Lack of necessary pressures and incentives

78. One of the reasons for reducing the level of central government support to local authorities and for the introduction of targets and penalties was to encourage authorities to secure improvements in economy, efficiency and effectiveness. Ministers have repeatedly made clear that they do not expect to see reductions in the level of central support offset by compensating increases in rates and/or reductions in services. Rather, they expect authorities to achieve better value for money. The twin pressures of ratepayers' resistance to rate increases, and targets and penalties were expected to result in energetic steps to reduce costs without adverse effects on local levels of services.

79. Nonetheless, this review suggests that expenditure targets and penalties have not been universally effective in inducing the desired shift in local attitudes. Table 18 below shows the major initiatives reported by Chief Executives responding to our survey as taken since April 1981 as a direct response to the effects of the pressures of targets and penalties.

Table 18: Major initiatives launched since April 1981
% Authorities Mentioning

<table>
<thead>
<tr>
<th>Initiative</th>
<th>% Authorities Mentioning</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Increases in charges</td>
<td>43</td>
</tr>
<tr>
<td>Recruitment freeze*</td>
<td>38</td>
</tr>
<tr>
<td>Reductions in Services</td>
<td>36</td>
</tr>
<tr>
<td>Cost Reduction in Refuse Collection</td>
<td>14</td>
</tr>
<tr>
<td>Corporate Reorganisation</td>
<td>11</td>
</tr>
<tr>
<td>Cost Reduction in Education</td>
<td>6</td>
</tr>
<tr>
<td>Administrative Cost Reduction</td>
<td>3</td>
</tr>
<tr>
<td>Other Cost Reduction Projects</td>
<td>21</td>
</tr>
</tbody>
</table>

80. While it would be unwise to read too much into the results of any questionnaire, with all the interpretation problems involved, the general conclusion is not inconsistent with other evidence available. For instance, refuse collection is perhaps the best researched service in local government and the "technology" for determining the appropriate costs and manpower for a given standard of service and how to achieve them has been available for at least the last five years. Yet, as Exhibit 15 (overleaf) shows, many authorities responsible for refuse collection do not have costs in line with demonstrably achievable levels on their existing policies - even though some authorities are certainly cost competitive; moreover the difference in costs implied by the analysis is far greater than would normally be expected in a well researched and technologically mature industry**.

81. The question to be asked is why have not all authorities faced with the pressures described above, taken energetic action to solve their problems by reducing costs without affecting standards of service? Others, including the Government, have commented on the inability of non-

* Selective as well as comprehensive, temporary and permanent

** For instance, the difference in cost per tonne between the highest and lowest cost (private) mill for certain categories of steel might be 10-15 per cent. The Commission's report Securing Further Improvements in Refuse Collection describes the differences among authorities in this service in detail.
Exhibit 15

Refuse collection costs vary considerably, against a common standard

REFUSE COLLECTION COSTS:
ACTUAL vs ROSS AUDIT

No. of Authorities

Source: Audit Commission analysis of ROSS Audit results
July, 1984
domestic ratepayers to influence authorities' expenditure plans and on the effects of rate rebates on council tenants’ attitudes to rate increases. The Commission is concerned in this instance with the impact of the grant distribution system on local economy, efficiency and effectiveness. We have concluded that the system itself does not encourage constructive action, for three main reasons.

(i) Local accountability for the management of services is blurred. The voters are generally not clear about who is responsible for priorities and expenditure levels, how local authority services are funded or how they are managed. As a result they cannot exert full influence over 'their' authorities;

(ii) There are few positive incentives in the present system to reduce costs; and the risks usually outweigh the likely rewards for members and officers alike;

(iii) There is significant central involvement in local decisions, often leading to conflicting "signals" from the centre to local government.

These may have combined to induce the attitude within local government that seeking to manipulate the system may be a more effective contribution to the local community than taking often painful action to improve efficiency.

This chapter discusses our findings under each of these headings in turn.

### Blurred Local Accountability

82. Effective local accountability should be a corollary of delegation of responsibility and authority for spending tax and ratepayers money. The hypothesis that local government provides a better insurance against waste by detailed understanding of the local situation and being better able to match local services to local needs than local administration must fail if local people do not hold their authority accountable for the way local services are managed.

83. There are three principal difficulties in the current arrangements which together cause confusion as to where ultimate accountability for local services lies:

(i) Political and managerial responsibility is not clear. On the one hand, central government departments are apparently planning in detail for local services as part of the Public Expenditure Planning process and to reflect Ministers' answerability to Parliament for what are seen in some senses as 'their' services. On the other hand, government continues to insist (e.g. in the Rate Support Grant Report) that local priorities are the responsibility of the local authorities. This inevitably causes confusion;

(ii) The general public are not as a whole clear about the basic responsibilities of different local authorities. So there is some uncertainty as to who should be called to account for what;

(iii) The "signals" that voters receive about local authorities' performance are both unclear and unreliable.

### Central Government's Planning for Local Services

84. As described earlier, every year central government devotes considerable effort to developing expenditure plans for the individual services operated by local authorities. These are published in successive Public Expenditure White Papers, and embody the results of much background analysis, interdepartmental discussion and Ministerial debate. Considerable time at central government and local level is devoted to agreeing these plans.

85. However, the difference between government's plans for individual
services and actual local government expenditure on them is quite substantial in absolute terms; and in percentage terms the variance can be quite large - approaching 50 per cent of planned expenditure in some cases, as Table 19 below shows. In each case, government’s planned expenditure as set out in the relevant Public Expenditure White Paper is compared with actual expenditure - as reflected in actual outturn in 1981-82, revised estimates in 1982-83 and budgets for 1983-84*.

Table 19: Local Authorities Services Expenditure - FY 1982-1984
Variance from Government Plans

<table>
<thead>
<tr>
<th>Service</th>
<th>FY 1982 £m</th>
<th>FY 1983 £m</th>
<th>FY 1984 £m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education</td>
<td>413</td>
<td>361</td>
<td>556</td>
</tr>
<tr>
<td>School Meals</td>
<td>151</td>
<td>87</td>
<td>147</td>
</tr>
<tr>
<td>Libraries</td>
<td>49</td>
<td>40</td>
<td>58</td>
</tr>
<tr>
<td>Social Services</td>
<td>255</td>
<td>125</td>
<td>139</td>
</tr>
<tr>
<td>Police</td>
<td>100</td>
<td>90</td>
<td>66</td>
</tr>
<tr>
<td>Fire</td>
<td>13</td>
<td>39</td>
<td>49</td>
</tr>
<tr>
<td>Transport</td>
<td>251</td>
<td>351</td>
<td>454</td>
</tr>
<tr>
<td>Environmental Services</td>
<td>119</td>
<td>112</td>
<td>224</td>
</tr>
<tr>
<td>Non-HRA Housing</td>
<td>12</td>
<td>13</td>
<td>44</td>
</tr>
<tr>
<td>Other Services</td>
<td>18</td>
<td>13</td>
<td>26</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,381</strong></td>
<td><strong>1,231</strong></td>
<td><strong>1,763</strong></td>
</tr>
</tbody>
</table>

86. On the face of it, therefore, central departments’ service plans seem to have relatively little impact on the allocation of resources at the local level. One possible explanation for the startling variances for some services is the obvious one: in the exercise of their discretion, local authorities collectively have arrived at judgements about local service priorities - as the RSG report suggests they may - which do not accord with those of the government.

87. Another possible reason is that the expenditure figures in the successive White Papers are not regarded as credible by local authorities - as implied by the response to our survey as outlined in paragraph 25. As one shire county Treasurer recently put it to the authority’s Policy and Resources committee: "The White Paper does not offer reliable information for the allocation of resources between services. Apart from the difficulties associated with cash planning [such as the need for agreed assumptions on wage and price inflation] comparisons of service expenditure between years are rendered relatively meaningless by the existence of varying amounts of current expenditure unallocated to service headings". Certainly, the implied changes in service levels have strained authorities’ credibility on occasion. Even assuming that the plans set immediately before a particular financial year begins are "solid", significant shifts in real service expenditure can be implied from year to year as Table 20 below shows.

Table 20: Planned changes in LA current service expenditure (plan to plan)
% , based on 1983-84 prices

<table>
<thead>
<tr>
<th>Service</th>
<th>Change Over Previous Year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FY 1983</td>
</tr>
<tr>
<td>Education</td>
<td>+2.7</td>
</tr>
<tr>
<td>Police</td>
<td>+ 2.2</td>
</tr>
<tr>
<td>Social Services</td>
<td>+11.7</td>
</tr>
<tr>
<td>Transport</td>
<td>+ 3.5</td>
</tr>
</tbody>
</table>

Source: Audit Commission analysis of successive Public Expenditure White Papers.

* These are the most up-to-date figures available to us. Previous years have shown relatively little difference between the three measures. For example, in 1981-82, total budgeted current expenditure for local authorities was £20.1 billion, the revised estimate was £19.74 billion and the outturn was £19.68 billion. The non-allocated margin in the Government White Paper has not been included.
88. The cost effectiveness of the Public Expenditure Planning process is no legitimate concern of the Commission. Our purpose here is simply to observe that there appears to be an inherent contradiction between Departments simultaneously appearing to plan (in the Public Expenditure White Paper) for the various local authority services, and insisting (in the Rate Support Grant Report) that local priorities are a matter for local authorities to decide. Under these circumstances, it is difficult for local electors to determine whether it is local politicians and managers or Ministers and civil servants who should be held responsible for the state of local services and their cost. Too often, the inevitable happens: when difficulties arise, each "side" blames the other.

The General Public Appears Confused

89. Most of those involved in administration of local authority affairs appear to assume that voters have a sound understanding of the structure of local government: who is responsible for what and how services are funded. As part of this review, therefore, some opinion research was undertaken to determine whether this assumption is soundly based. A nationwide sample of over 2,000 people eligible to vote in local elections was interviewed in late March. The research suggests that many voters are confused in some important respects:

(a) Many people think that some important local services are actually provided by central government. Specifically, 37 per cent of respondents interviewed regarded the police as entirely a national responsibility, 26 per cent regarded further education as being a service provided by central government alone and 18 per cent regarded the fire service and secondary education in this light as well;

(b) The roles of district and county councils are still not well understood, a decade after the 1974 reorganisation of local government. 42 per cent of the sample thought that council housing was a county responsibility and 37 per cent considered that refuse collection was as well;

(c) Over a quarter (27 per cent) did not know, even approximately, where the money to pay for local services came from; and of those who did have an opinion, 16 per cent considered that central government contributed on average less than 20 per cent towards the cost of local services; and 19 per cent thought that central government contributed over 50 per cent;

(d) Voters had only the sketchiest idea as to how much it cost to provide basic services. The following table shows answers to the question: "If the local authority were to charge you separately for the cost of collecting your refuse, how much do you think their charge would be for one week?"

<table>
<thead>
<tr>
<th>Perceived cost of refuse collection</th>
<th>% Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>£ per household per week</td>
<td></td>
</tr>
<tr>
<td>Under 50p</td>
<td>23</td>
</tr>
<tr>
<td>Over 50p – £1.00</td>
<td>29</td>
</tr>
<tr>
<td>Over £1.00 – £1.50</td>
<td>11</td>
</tr>
<tr>
<td>Over £1.50 – £2.00</td>
<td>8</td>
</tr>
<tr>
<td>Over £2.00</td>
<td>14</td>
</tr>
<tr>
<td>No Opinion</td>
<td>15</td>
</tr>
</tbody>
</table>

In 1982-83 the cost of collection per hereditament in districts was 43p a week.
90. In short, despite recent initiatives such as the introduction of annual reports, there is a disturbing level of ignorance among many members of the public about who is responsible for providing particular services and how much they cost. While it would be naïve to suggest that most members of the public would ever want to interest themselves in the intricacies of local government finance, it is difficult to believe that local accountability can be fully effective without voters having at least a basic appreciation of the way local services are managed and funded. The very complexity of the arrangements for funding local authority services and for distributing government grant - and the lack in many cases of information presented to members and voters in a timely and comprehensible fashion - makes this level of uncertainty understandable. But it means that local accountability is unlikely to be as effective as it should be.

**Performance Measures Are Unreliable**

91. One obvious measure of an authority’s stewardship of resources could be expected to be changes to the level of local rates. If rates fall in real terms, voters might reasonably be expected to conclude that their council has been doing a creditable job, at least in terms of economy; if they rise faster than inflation, voters might have grounds for concern, unless they perceive a corresponding improvement in local services. As recently as June 1982 a senior DOE official was writing as follows: "As Julian Le Grand put it in the September 1975 issue of the *Economic Journal*, for fairness in distribution of a grant . . . the value for (unit costs of per capita output) used in the grant formula should not be an authority's actual costs per unit, but its potential costs: the value which would pertain if the authority successfully minimised costs'. To do less is to reward inefficiency at the expense of the efficient. The same argument applies in equalising local tax rates. The present rate support grant system should already give the elector a signal that, if his rate in the pound is markedly lower or higher than those elsewhere, he should be getting a correspondingly lower or higher standard of services; but it does not yet meet Le Grand’s criterion. As we shall see, it is designed to approach it". (Public Money, June 1982, page 40) Indeed, Ministers regularly imply that the reasons for what they regard as "excessive" increases in rates have been councils' spending policies.

92. However, as Exhibit 16 opposite shows, there is only a weak statistical relationship between changes in expenditure and changes in rates - because of the effects of the reduction in the percentage of local government expenditure met from the rate support grant, changes in targets, the impact of penalties for spending above them and the build up of reserves, all of which were discussed earlier. Furthermore, the situation can be shown to have deteriorated since 1980–81 when there was a relatively strong statistical relationship between changes in rates/precepts and expenditure levels. Thus, a ratepayer could not draw any reliable conclusions about the actions of the local council from trends in rates. In some cases, total expenditure has fallen, while rates have increased. For instance, one metropolitan authority reduced expenditure in cash terms by £3.3 million (4.9 per cent) in 1983-84, increased housing rents by £2 a week (around 14 per cent) and had to increase its rates by 20 per cent. In other (rarer) cases, rates have remained static in real terms while expenditure has increased significantly. In short, the most obvious - and only readily understandable - indicator of an authority’s performance from the standpoint of an individual voter is not very reliable.

93. There is further complication in that districts and London boroughs collect rates from other (precepting) authorities over which they have no
Exhibit 16

There is no apparent relationship between expenditure and rate increases in FY 1984.

ENGLAND: NON-METROPOLITAN DISTRICTS

* Rate and grant borne expenditure

Source: Cambridgeshire County Council
control. The rate demand covers the costs to the ratepayer of all the authorities in question. We doubt, judging by the response to our March poll, whether many voters disentangle the effects on their rates of the actions of the various authorities involved. The Borough of Hammersmith and Fulham provides an example. Table 22 below breaks down the rates bill for a resident of the Borough of Hammersmith and Fulham and shows that only a relatively small proportion of the total rate is in fact under the direct control of the Borough Council.

Table 22: Rates in the Borough of Hammersmith and Fulham - FY 1985

<table>
<thead>
<tr>
<th>Service</th>
<th>Poundage</th>
</tr>
</thead>
<tbody>
<tr>
<td>GLC and other precepts</td>
<td>37.54</td>
</tr>
<tr>
<td>ILEA</td>
<td>80.00</td>
</tr>
<tr>
<td>Metropolitan Police</td>
<td>12.09</td>
</tr>
<tr>
<td>Borough of Hammersmith and Fulham</td>
<td>70.97</td>
</tr>
<tr>
<td>Receipt from equalisation pool</td>
<td>(11.62)</td>
</tr>
</tbody>
</table>

94. Although many authorities provide details of where rates go to, in all probability most ratepayers look at the total rates bill, where it comes from and to whom they make out the cheque - and naturally conclude that the authority levying the rate bears at least some measure of the responsibility for changes in the overall level of the rates bill. In some cases, this conclusion would be unreasonable. The Commission therefore welcomes the Government's proposal that all ratepayers should receive a separate notice of the poundage and amount being levied by the rating authority and by each major precepting authority.

* * *

Lack of Positive Incentives to Reduce Costs

95. Any change in local services is likely to carry with it considerable problems for members of councils and their officers.

96. Since barriers to change are almost invariably formidable, and since as we have shown there is unlikely to be any concerted pressure from local ratepayers for action to reduce inefficiency, there need to be powerful incentives to encourage authorities to take the steps required.

97. These incentives are largely absent. At the level of the individual senior officer, performance-related pay is conspicuous by its absence within local government; and the pressures of the special interest groups and the threat of criticism by the Ombudsman discourage risk taking.

98. Indeed, for an authority there is a perverse incentive in the need to spend up to its expenditure target. Increases in past expenditure have resulted in higher targets. Members and officers planning cost reduction initiatives thus face the risk that their efforts will be "rewarded" by a lower target against which future penalties will be assessed; and that their neighbours taking a more cautious approach will see this caution reflected in a higher target - and thus more "room" for possible service development and less need for painful staffing adjustments. The following comments from senior officers in authorities visited during our fieldwork provide a flavour of the present atmosphere within local government.

"The influence of the grant system, if there has been any, has been to reduce the pressure for spending cuts. In addition, if the council had made contributions to special funds instead of building General Rate Fund balances, grant would have been increased by approximately £1m."

"The County Council was penalised in 1983-84 because it was more optimistic (in its budgets) about inflation rates in 1982-83 than other authorities."

"We followed the Government's exhortations to reduce expenditure in
1981-82. As a result, we suffered lower targets. We will not be caught out again. In 1983–84 and 1984–85 we budgeted to spend at target plus two per cent."

"Now our priority is to protect expenditure levels and to manipulate the grant system rather than to pursue value for money. For example, the 1984–85 estimates are "padded" to produce a budget of target plus one-and-a-half per cent, in case future targets are based on estimates."

"We have responded to uncertainty over grants and the system generally by inflating outturn expenditure by creating funds and prematurely repaying debt."

"Any authority who in the current year has a target below GRE and deliberately chooses to ignore the target and incur expenditures up one per cent above GRE [a difference of as much as ten per cent in some instances] is now being given a higher target for next year than those authorities who - despite population growth, for which no allowance is made - endeavour to reduce their expenditure in order to be within target."

These general attitudes have become pervasive in many authorities. A recent HMI report noted a not untypical situation in a shire county secondary school, "a technician maintains the 16-position language laboratory, though this has not been used by the language department for some time". Such an attitude by authorities and staff is, sadly, not uncommon.

99. The relationship between expenditure trends and targets is shown in Exhibit 17 overleaf. The effect of the present arrangements for grant distribution on local management attitudes is perhaps best summarised by the Treasurer of a shire county who recently reported to his finance committee as follows:

"It will be recalled that the Council's budget for 1983-84 was fixed at the same level as the target set by the government. This level of expenditure maximises the Council's Block Grant, because expenditure above target incurs grant penalties and expenditure below target forfeits grant at a marginal rate of about 20 per cent. In normal circumstances I would not advise the Council to spend more money, merely to increase grant entitlement. However, a continuation of the present system of targets and grant penalties means that 'spending' up to budget (providing it does not exceed target) will not only earn budgeted grant income but, more importantly, can also be used to relieve future budgets. This in turn reduces the effect of any future budget reductions which may be necessary and helps to eliminate grant penalties. It is assumed, therefore, that the Council will wish to 'spend up' to its 1983-84 budget. In which case consideration needs to be given to the best ways of using the £[millions] available."

100. The side effects of targets and penalties also give rise to evident anomalies at the local level which distract management's attention from the task of improving efficiency and effectiveness. For instance:

(a) even though "straight-line" debt repayment schedules (ie repaying part of the principal every year and paying interest on the declining balance) may be more advantageous for authorities in the long run than payment of an annuity, authorities can be penalised for incurring higher costs in the early years of a loan;

(b) shire districts' total expenditure for target and penalties purposes is taken to include parish precepts - over which the district council has no statutory control. A shire district could therefore find itself losing grant because the parish expenditure has increased faster than the rate of inflation. Table 23 on page 55 illustrates the position in four districts in Nottinghamshire.
Exhibit 17

Increases in expenditure are reflected in higher targets

ENGLAND: SHIRE COUNTIES AND MET DISTRICTS

%
Thus, the parishes in the four districts in question in effect pre-empted over 25 per cent of the increase in the districts' cash expenditure targets; so, had the districts increased their spending in line with the 2.1 per cent increase in targets, they would have lost £42,000 of grant between them - not a massive sum, but an irritant nonetheless.

(c) Penalties also deter councils from taking appropriate accounting action. For instance, as the Commission's report *Bringing Council Tenants Arrears Under Control* shows, arrears now exceed £250 million. Auditors will expect to see non-recoverable arrears written off. Yet, this may cost an authority in penalty several times the amount involved. For example, if a London borough were to decide to write-off (say) £9m of tenants' arrears this accounting action could cost the ratepayers over £30m, because of the authority's position with respect to expenditure against target. A number of authorities are likely to find themselves in this position, and may well decline to write-off arrears for this reason, even though they may not be recoverable. As a result, we expect that auditors may have to qualify their opinions on these authorities accounts - and the impact of qualification will inevitably be reduced, as will be the value of the accounts to local ratepayers.

* * *

101. Finally, officers are often deterred from recommending action that would clearly be cost effective because of prevailing hostility in many quarters to any and all changes in white collar staffing levels combined with the use of crude staffing measures - in particular pupil/teacher ratios and uniformed police establishment levels. The Commission is concerned that the overhead burden within many authorities is too high. Nonetheless, blanket opposition to any white collar staffing changes produces perverse effects. For instance, exploitation of new technology is often impeded (since some increase in white collar staff is usually involved) even where the returns on the investment are very attractive; increased use of civilians in the police force can be made even more difficult than it is already; authorities can be reluctant to employ support staff in schools (e.g. in laboratories) even though teachers are unproductively employed as a consequence.

102. In short, under the present arrangements the balance of incentive is for local authorities to budget at or above target, to secure a higher target next year. The present arrangements do not appear to be encouraging many authorities to take action to secure better value for money. Those that are taking appropriate measures are often doing so in spite of the system, not because of it. Moreover, there is a widespread feeling within local government generally, that savings are likely to be "clawed back" in lower Rate Support Grant in future years - a feeling that complicates the Commission's task in promoting value for money. The importance of
incentives was recognised by the DOE official in the Public Money article referred to earlier (paragraph 91, on page 50):

"Of course, if the gains of improved efficiency are pre-empted by corresponding increases in the expected local tax burden (or decreases in grant), the system comes at once to a halt. It ceases to be in the interest of the local authority associations to reach for higher efficiency costing in one another's services. Instead they will - with some central spending Departments as their allies - press for 'quality' improvements resulting in higher costings. Central government financial organs can be assumed to be aware of that trap: and to continue as heretofore on the politically and economically sensible course of planning for an aggregate local tax burden (or grant total) set on broad policy and economic grounds".

103. The Financial Management Initiative emphasises the importance of delegation of responsibility, authority and accountability to local line managers. The same principle is fundamental to the effectiveness of any successful business. The corollary of delegation from the centre to the local level is that, save in the most exceptional circumstances, the centre will not become involved in "second guessing" line management. Financial Management in Government Departments* recognises the problem: "Central government needs to ensure that its own means of influencing local authorities through controls, grants, borrowing approvals etc are operated in such a way that individually and collectively they result in good practice, efficiency and effectiveness in local government . . . Specific controls tend to involve additional administrative effort at both local and central levels; they need to be scrutinised periodically, therefore, to see whether their administration can be simplified and made more efficient".

104. However, in practice central departments often intervene in matters of local detail and/or offer contradictory "guidance". The Department of Education and Science, the Home Office and the Department of Health and Social Security often urge higher spending on authorities while the Department of the Environment seeks to "rein in" their current expenditure via the network of systems described earlier. The implied growth in some of the service expenditure plans published by the government (paragraph 87, p 48) adds to the general confusion. As one Chief Executive put it: "It adds very greatly to the difficulties of managing service reductions for a population whose expectations are continually being raised".

105. During our study, five services or programme areas in particular have been identified where local authorities often find their intentions to secure better value for money frustrated by detailed central intervention in what, managerially at least, should be a local responsibility.

(i) School Closures. The rate at which secondary school places are being rationalised is falling seriously behind demographic projections and local authority targets as Exhibit 18 opposite indicates; and the quality of education in many schools is threatened as a result. Even though the GRE formula for secondary education costs implies that places will decline in line with school rolls (with a 21-month time lag) the Department of Education last year turned down one proposal in three for closure even where the LEA has prepared a reasoned and substantiated case for closure on education grounds and has completed the arduous (two year) consultation process**. Often the

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* Cmnd 9058, September 1983

** According to DES, proposals for the closure of 89 schools were submitted in 1983. The Secretary of State rejected the proposals for the closure of 26 schools; proposals for the closure of 6 schools were approved only after modification.
Exhibit 18

The Department of Education does not expect all surplus school places to be closed.

SECONDARY SCHOOL PLACES IN ENGLAND AND WALES (‘000)

* Circular 2/81
Source: Department of Education and Science, A Study of School Building
review of a closure case can take a year or more and it is sometimes not clear in the field what criteria are being used centrally in evaluating reorganisation schemes. It is clear that there is often a conflict between the policy intentions which underlie the GRE in this instance, and central decisions (by architects of the policy) on individual cases.

(ii) Housing Programmes. As described earlier, the appropriateness of the basis on which Housing Investment Programme (HIP) allocations are distributed is questionable. The allocation is very detailed (i.e. to the nearest £000's – or one twentieth of the cost of an average house). As a result members' ability to respond to local needs as they perceive them is restricted. Since many district councillors see housing as their most important responsibility, frustration is the inevitable result.

(iii) Uniformed Police Establishment. Home Office-approved establishment levels for local police forces are often inconsistent with GRE; and potentially they can make it more difficult to introduce a higher proportion of civilians into a local force, even though this is clearly cost effective*. In one force, the Home Office has approved a uniformed establishment which is above average in relation to the local population, reflecting the high local crime rate and national security considerations. However, the local GRE fails to reflect the spending levels associated with the approved establishment. If the local authority decided to spend at the manning levels implied by GRE for the local police service, it would have to reduce the uniformed establishment by 700 (or 15 per cent). The difference is an overspending of £14m, in an authority already in serious penalty problems.

Moreover, centrally negotiated pay settlements can mean that existing police (and fire) establishments are more expensive to maintain than the authority might have expected. For instance, following the Edmund Davies pay award to the police, the GRE for the metropolitan police (where GRE always equals expenditure) rose by over 20 per cent, while that for provincial forces increased by under half this amount.

(iv) Fire Service Establishment. The Home Office also agrees establishments for the fire services and minimum fire cover requirements for certain categories of risk. One shire county visited in the course of this study would need to reduce establishment by over 100 and withdraw four appliances if spending was to be brought into line with GRE for the local service. It is claimed that these reductions would mean that the local fire service was not able to meet the response times for emergencies laid down by the Home Office.

(v) Inner City Programmes. Several Inner City authorities have observed that they find it strange that additional government funds for their areas can only be spent on what they consider lesser priority projects - i.e. projects that would not otherwise have taken place. Moreover, a number of incidences were reported where an authority is liable to be penalised for providing necessary support to government sponsored Inner City initiatives.

106. In addition, Parliament sometimes enacts legislation or approves instructions affecting local authorities without ensuring that the necessary resources are available to meet the expectations thus raised. The Local Authorities Conditions of Service Advisory Board (LACSAB) recently

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* See the Commission's Handbook on Economy, Efficiency and Effectiveness for details
published an interim report* that identified 12 principal initiatives and a further 26 secondary initiatives by central government since 1979. The survey suggests that the equivalent of at least 7,000 additional full-time posts have been filled locally to respond to these initiatives at an annual cost to local authorities of well over £60 million a year.

107. The difficulties can be compounded by advice from central government departments. For example, a shire county with a target below GRE was urged by the DHSS last year to increase its low spending on social services: "Goodwill cannot compensate for gross shortages in the main services. What is really needed is a substantial injection of additional money, to recover from the original low base. Priority should be given to a substantial increase in the home help services . . . more occupational therapists, more meals on wheels and the development of low cost day centres". Almost simultaneously with this advice, a DOE Minister was expressing his "disappointment that the council intends to exceed its target for the fourth successive year".

108. Finally, on the theme of central involvement in local affairs, there has been a recurrent concern among the local authority members and officers at the level of central involvement in the details of individual capital expenditure projects. This is not strictly part of this review, which is concerned with arrangements for the distribution of Block Grant. Since the Commission's examination of capital expenditure controls is just beginning, this subject will be dealt with in a separate report.

109. This section has discussed the extent to which the present arrangements for distributing Block Grant meet the requirements for sound management. It has suggested that these requirements are not fully met. It is often not clear where authority and responsibility for local services lies; accountability is therefore blurred. Even though some ambiguity is probably inevitable given the mixed sources of funds for these services, the present level of confusion seems undesirable from a managerial standpoint. Finally, there are few positive incentives and some perverse ones standing in the way of steps to improve local economy, efficiency and effectiveness.

The final section of this report suggests the general outlines of a possible way forward.

4 The way forward

110. With no increases in Special Funds or (net) contributions to rate balances, rates over the past 2-3 years would have been £400 million lower. To sum up, the Commission has concluded that major changes need to be made to the present arrangements for distributing Block Grant.

111. While it may be argued that tighter central controls - e.g. to make it more difficult for authorities to build up rate balances and to establish special reserves - are indicated by some of the evidence in this report, the Commission does not believe this to be appropriate. What is needed is to put the basic principles of sound business management and of the Financial Management Initiative into practice: less system-induced uncertainty, more financial stability, more delegation, stronger local accountability, less second guessing from the centre, more consistency, less complexity, more local flexibility.

112. The broad changes necessary to meet these requirements are as follows:

(i) The level of the total central government cash support to local authorities and in particular the proportion of relevant expenditure to be met from the Aggregate Exchequer Grant needs to be set out for three years ahead. The balance between specific grants to fund national initiatives and Block Grant support for local operations needs to be clear for the same period;

(ii) The existing shortcomings in information on needs and local property values need to be corrected — distributing £8.6 billion in part on the basis of poor information is a false economy;

(iii) Block Grant support to authorities should be distributed on the basis of a more robust (and ideally simpler) GRE and up to date rateable values. Among other benefits, assuming accurate information, this should result in a more predictable grant entitlement for individual authorities;

(iv) If government wishes to reduce total local government expenditure, this should be achieved primarily via reductions in grant i.e. in the percentage of relevant expenditure to be met by RSG;

(v) Local authorities' expenditure targets different from GRE (revised) should be abolished as soon as practically possible, thus removing some of the perverse incentives in the present system. Local market forces (i.e. the local electorate) should eventually determine the level of local expenditure — provided that local accountability can be suitably strengthened;

(vi) Close-ending should be abandoned as soon as possible; and in any case mid-year adjustments in grant to authorities spending within their budgets should be avoided;

(vii) Local authorities should be left to change their allocation of Block Grant resources without detailed intervention from central government. Where central government have specific priorities they should use specific grants or be achieved via legislation.

These changes are in line with the general principles of the Financial
Management Initiative. They are also the changes that the questionnaire shows that most Chief Executives in local government consider would contribute to the achievement of greater value for money in their authority.

113. The changes proposed constitute a package which would tackle the underlying causes of the problems identified in this report directly. As a result, both rates and the cost of the Whitehall overhead burden involved in oversight of local government should be reduced. Because the changes constitute a package, adopting some of the proposals without others could do more harm than good.

* * *

114. The Commission believes that this report demonstrates the need for some basic changes in the way Block Grant is distributed to local authorities. Although the Commission is well aware of the complexities, the size of the sums involved and the social and managerial implications of failure to correct a situation that is clearly unsatisfactory, suggest that urgent action would be justified. A detailed review should be undertaken to develop proposals for overcoming the weaknesses set out in this report and to deal with the inevitable transitional difficulties. The review would need to show the net effect on grant receivable by individual authorities and the consequential impact on local rate levels resulting from the combination of the application of a simpler and more robust GRE, use of up-to-date information on local property values for grant distribution purposes and the abandonment of the present penalty arrangements. It should be completed urgently. A review of the extent, costs and benefits of any overlap between central departments and local authorities in the oversight of local government services could also be completed within the same time scale. Both these reviews are not within the Commission's sphere of responsibility; but its services are available if required.
1. This appendix describes Block Grant as it has operated since it was introduced in 1981. It examines the objectives set out for parts of the system during the debates of the *Local Government, Planning and Land Act, 1980* and the *Local Government Finance Act, 1982*. The basic Block Grant arrangements are described, as is the system of targets and penalties which has been grafted onto the arrangements originally envisaged. An attempt is made to identify the purposes ascribed to features like 'safety nets', 'multipliers', 'grant related expenditure', the 'London arrangements', 'targets' and 'penalties'. Since it is obviously important to have an agreed view of the system, this appendix has been discussed with relevant officials within the Department of the Environment; and their comments have been incorporated.

2. Block Grant was introduced by the *Local Government, Planning and Land Act, 1980*. This reformed the existing Rate Support Grant (RSG) so as to combine the 'needs' and 'resources' elements which had operated since 1967. The new grant seeks to fulfil in a single exercise the two separate objectives of the old elements, equalising between authorities' spending needs and their rateable resources.

3. The starting point for each year's RSG settlement is the determination by the Government, made after consultation with the associations of local authorities but ultimately in accordance with its own financial and economic policies, of provisional figures for local authority total expenditure and Government grants towards the expenditure. From the planned total of Government grants, referred to as the Aggregate Exchequer Grant (AEG), there is first deducted the estimated amount of various specific and supplementary grants payable by the Government, towards the costs of particular local authority services; the balance remaining represents the amount available for the payment of Rate Support Grant (RSG). The first charge on this balance is the payment of Domestic Rate Relief Grant (DRRG) to reimburse local authorities in full for the loss of revenue resulting from the granting of relief to domestic ratepayers at rates prescribed by the Secretary of State, currently 18.5p in the pound, with proportionate amounts for the occupiers of mixed domestic and business premises. The amount then remaining, which is treated as a cash-limited provision, is available for distribution to local authorities as Block Grants towards their total expenditure.

4. The new grant system operates by equalising the rate poundage cost to authorities of different levels of expenditure in relation to an assessed spending need figure. That is, ratepayers should expect to be paying the same rate in the pound for the same standard of services regardless of the local resources. This spending need figure is calculated by a formula which is designed to take account of local authorities' different social and demographic characteristics. The formula is built up from over 60 separate pieces of analysis. The system used previously relied on an analysis of the relationship between past spending and a range of social and demographic factors (known as 'stepwise multiple regression analysis'). The new system
is largely based on factors determining the need for services. The various factors, demographic, geographical, social, environmental, etc., which might be expected to affect the spending needs for each service are identified, quantified and given appropriate weightings; the resultant formulae are then used to apportion the national total for that service to individual local authorities. The sum of the separate service apportionments for each authority constitutes its grant-related expenditure assessment (GRE).

5. A grant-related poundage (GRP) is then set which it is assumed for purposes of grant distribution a local authority would charge if it spent at the level of its GRE, with a formula to determine variations in GRP for authorities which chose to spend at levels other than GRE. GRP is set so that, taking all tiers of local government together, the rate in the pound at ratepayer level would be the same across the whole country at similar levels of spending in relation to GRE. Block Grant fills the gap between spending and the amount yielded in an authority by its GRP.

6. The basic formula for the distribution of Block Grants thus provides for each authority to receive a grant equal to the difference between its total expenditure, defined in the same way as in the provisional figures (see paragraph 3) and the product of the total rateable value of its area and grant-related poundage prescribed by the Secretary of State. Its general effect is to enable an authority to finance its actual expenditure by levying a rate or precept equal to its prescribed GRP. The amount of the prescribed GRP depends, however, upon the relationship between the authority's expenditure and its GRE. For spending equal to GRE the effective GRP for the ratepayer is fixed at the common national level, shared between the authorities in different tiers in proportion to the total GREs for those tiers. For spending below GRE, or above GRE up to a specified threshold, the prescribed GRP is reduced or increased by 0.6p for each £1 per head of population which an authority spends below or above its GRE. The threshold is set at a fixed level of spending per head, equal to 10 per cent of the national average GRE per head shared proportionately between the authorities in different tiers. The prescribed GRP is increased by a further 0.75p for each £1 per head which an authority spends above its threshold. The common national GRP is set at the level necessary to absorb the whole of the amount available for Block Grants if all authorities spent at their targets.

7. The Secretary of State is empowered to modify the basic distribution formula, by applying multipliers to the prescribed GRPs, for certain specified purposes. A multiplier of less than 1 reduces the rate poundage or precept which an authority needs to levy to finance a given level of expenditure; and a multiplier of more than 1 increases it. This power has been used to limit the prospective loss of grant by some authorities resulting from certain changes between years in the calculation of their GREs. In 1984–85 these were:
   (i) changes in GRE methodology;
   (ii) changes in all GRE data (apart from numbers of school pupils and further education students in the GRE for education);
   (iii) changes in grant compared with the 1983-84 position resulting from the removal of 1983-84 safety nets.

8. Multipliers have also been used to moderate the effects of the relatively high rateable values of properties in London on the grant entitlement of the local authorities within Greater London. Although they are included within the overall Block Grant arrangements, London authorities are notionally assumed to charge lower grant-related poundages for spending at GRE than authorities elsewhere. In addition, Inner London
is assumed notionally to charge somewhat lower poundages than those in outer London.

9. These adjustments - for safety nets and London arrangements - plus a small modification to the Block Grant of authorities within the Metropolitan Police District though outside the Greater London Council area are made by use of the multipliers.

10. The Government has grafted a system of spending targets and grant penalties onto the basic operation of Block Grant. These operate under the Local Government Finance Act, 1982. A target is set for each authority. This is done using a different method than that for setting GREs. Targets for 1984–85 have been set by adding 2.5 per cent to the higher of each authority's 1983-84 GRE or target, subject to the constraint that no authority having a target which is more than 3 per cent above nor more than 6 per cent below (with a minor exception) their 1983-84 total expenditure.

11. If an authority decides to spend above target, it is penalised by losing Block Grant. Both targets and penalties are prescribed by the Government. In 1984–85, the penalty (at ratepayer level) will be a grant loss equivalent to a 2p rate for one per cent of spending in excess of target; a grant loss of 4p for the second one per cent of excess; 8p for the third one per cent and 9p for each additional one per cent. Thus, if each tier of authority exceeded target by 6 per cent, this would imply grant penalties equivalent to a 41p rate. These penalties are split between tiers of local government in proportion to each tier's share of total GRE. These arrangements (for setting targets and determining penalties) operate in 1984–85. Similar arrangements were made in 1981-82, 1982-83 and 1983-84, involving targets and penalties set in a different way in each year. Penalties are enforced by use of the multiplier discussed above.

12. Each year, the operation of Block Grant and some of its objectives are laid out in the Rate Support Grant Report (England). A separate report is published for Wales. Each has to be approved by Parliament. There may be several supplementary reports (during the three years following the original report) to revise information in the original report. Each of these is subject to an affirmative resolution of the House of Commons.

Each RSG Report contains sections dealing with the total of relevant expenditure, aggregate exchequer grant and the division of this aggregate grant between specific and supplementary grants on the one hand and RSG on the other. The tables of grant available for each of these grants and a description of how each is to be distributed among authorities are included in the Report. Sections also deal with the setting of targets and penalties, the London arrangements and a number of other features.

13. The normal sequence of events relating to the assessment and distribution of RSG usually starts some 12 months before the beginning of the financial year, with the opening of consultations with the local authority associations on the Government's proposed provisional figures for local authority total expenditure and grants on the distribution arrangements. In the light of these preliminary consultations the Secretary of State usually announces the Government's conclusions on the provisional figures, and advises local authorities individually of their provisional expenditure guidance targets, in the summer. After considering any representations made by individual local authorities, and further consultations with the associations on the distribution arrangements, the Secretary of State makes his final determination of all the factors to be taken into account in the RSG settlement two or three months before the beginning of the financial year. These are incorporated in a formal Rate Support Grant Report submitted for approval by the House of Commons.

14. Local authorities are then advised individually of their final
expenditure targets, their GREs and all the other factors necessary to enable them to calculate their approximate grant entitlement for any given level of expenditure. This information is taken into account by the authorities in fixing their budgets and their rate or precept poundages. They are then required to submit to the Department of the Environment (DOE) Returns of Expenditure and Rates (RERs) giving full details of their approved budgets. Pending the analysis of these returns DOE pay grant instalments on the assumption that every local authority will be spending at the level of its expenditure target. Pending the availability of RER data, instalments of grant are paid on the basis of authorities' initial Block Grant claim forms (Form BG8 for 1984–85). When the information contained in the RERs has been analysed, the total amount available for Block Grants is redistributed to accord with the budgeted expenditure of each authority; and, after further consultation with the local authority associations, the arrangements for imposing penalties on authorities budgeting to spend more than their financial guidance targets are finalised. These adjusted provisions are incorporated in a Supplementary Rate Support Grant Report submitted for approval by the House of Commons, normally in about July of the financial year (i.e. about three months after the beginning of the year in question). After the close of the year local authorities are required to submit to DOE Revenue Outturn (RO) forms, followed in due course by audited statements of actual expenditure. These lead to further adjustments to the distribution of Block Grants and the imposition of penalties, and to the submission of further Supplementary Rate Support Grant Reports for approval by the House of Commons.

15. The process of calculating the entitlement to Block Grant for an individual authority is described in the attachment, which is based on information in respect of a metropolitan district and on a Commentary on Block Grant produced in 1983 by the Society of County Treasurers.
1. Block Grant = Expenditure - [Rateable value × Grant-related poundage × Multiplier]
   This is the basic formula for calculating an authority’s Block Grant. 'Expenditure' is the level of 'total' expenditure budgeted for by the authority, 'grant-related poundage' is determined by the relationship between expenditure and GRE. 'Multiplier' is for purposes described in the text.

2. GRP is thus calculated by the following formula.

   \[
   \text{GRP} = \text{GRP}^* + 0.6 \left( \frac{\text{Total expenditure} - \text{GRE}}{\text{population}} \right)
   \]

   *GRP is the GRP for spending equal to GRE for the relevant class of authority, assuming it spends at GRE. If the authority decides to spend at a level other than GRE, the formula will determine increases in reductions to GRP*.

3. For an imaginary metropolitan district with the following characteristics:

   - Population: 250,000
   - Rateable Value: £25,000,000
   - GRE: £100,000,000
   - GRP*: 130.00
   - Multiplier: 0.985000
   - Expenditure: £104,500,000

   the calculation of Block Grant in 1984–85 would be:

   \[
   \text{BG} = \£104,500,000 - \left[25,000,000 \times 130.00 \times 0.985000\right]
   \]

   \[
   = \£104,500,000 - 34,672,000
   \]

   \[
   = \£69,828,000
   \]

4. The authority's GRP is 140.8 for spending at £140.5 million. Block Grant can now be calculated:

   \[
   \text{BG} = \£104,500,000 - \left[25,000,000 \times 140.8 \times 0.985000\right]
   \]

   \[
   = \£104,500,000 - 34,672,000
   \]

   \[
   = \£69,828,000
   \]

5. Thus, for spending at £104.5 million, the authority would receive £69.8 million grant and would have to raise £34.7 million in rates. If it had chosen to spend at a level above its 'threshold' (set 10 per cent on average above GRE), a different formula would have been used to determine GRP, and thus to calculate Block Grant. The formula (replacing that in (2) above) would be:

   \[
   \text{GRP} = \text{GRP}^* + 0.6 \times \text{Threshold}^* + 0.75 \left[\frac{\text{Total expenditure} - \text{GRE} - \text{Threshold}^*}{\text{population}}\right]
   \]

   *Threshold is the amount, expressed in £ per head, by which the threshold exceeds GRE.
The effect of using this formula is to charge an additional 0.6p extra to the authority GRP* for each extra £1 per head of spending up to the 'threshold', and an extra 0.75p for each £1 per head above the threshold.

6. The effect of using block grant calculated in this way is such that the relationship between spending and grant is different from authority to authority. The figure below gives three examples to illustrate the ways in which Block Grant can vary with expenditure:

7. Line A shows an authority with high spending needs and high rateable resources. Grant declines at all points beyond where GRP = 0 because of the authority's high rateable value. (The additional GRP for each £1 per head of spending brings in rate income greater than £1 per head). Line B is an average metropolitan authority, where grant continues to increase even beyond threshold (this is because an additional £1 per head of spending brings in additional rate income of less than £1 per head even beyond threshold). Line C shows an authority with relatively low GRE and relatively high rateable resources, where grant increases slowly up to the threshold and decreases thereafter.

8. The effect of targets and penalties is to put all authorities in the position of losing grant for spending above target. If superimposed on the figure above, the 'grant' line would begin to fall at or just over target for any authority.
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