CONTROL OF LOCAL AUTHORITY EXPENDITURE – THE USE OF CASH LIMITS*

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INTRODUCTION

Until 1979/80 the volume of local authority revenue expenditure had been growing sharply. The financing of this rise in the volume of revenue expenditure has come partly from the local property tax (the rate) but mainly from increases in central government grant aid.

The growth in grant aid has made local government's relationship with the central government increasingly vulnerable. In the development of that relationship several factors have emerged with different emphasis being given to each at different times. But a major problem for local government in controlling its expenditure and in its relationship with central government is a lack of cohesiveness in local government (the main groups of local authorities just do not agree on fundamental issues) and a lack of consistency in the approach of the central government towards the finance of local authorities. Local authorities have therefore not been able to predict with any certainty the financial consequences for themselves and their electorates of any particular decisions about expenditure.[1]

The factors in the relationship between central and local government which have assumed varying degrees of significance are:

(i) the problem of containing local government expenditure;

(ii) a concern that public expenditure in general and local authority expenditure in particu-

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[1] The organisation of the local government system in the UK is described in the Appendix.

lar has just been growing too fast and that the demands made by bureauracies for resources are greater than what the nation as a whole is prepared to support;

(iii) a concern about the effectiveness of local government expenditure in solving local social and economic problems;

(iv) a concern about the efficiency of local government;

(v) the decline in the accountability of local authorities to their electorates;

(vi) a view that bureaucracies cannot be trusted to make the 'right' decisions and consequently that more decisions over the use of resources should be returned to the individual.

Part of the problem of predictability is that a consistent policy towards local government finance in general does not exist and the existing framework has been constantly modified on an 'ad hoc' basis to meet particular situations as they occurred. The result has been a heavy emphasis on initiatives by the central government. These have tended to give it greater power over the financial policies of local government in general and of individual local authorities in particular. The central government has not yet achieved absolute control over local authority revenue expenditure, but it has virtually achieved that over local authority capital expenditure.

At the present time the main concern of central government is about local government expenditure containment and the policies that are evolving are all aimed at this objective. A particular problem for the central government in achieving its objective is that the political control of local government is moving away from those broadly sympathetic to its public expenditure containment policies to those who believe that higher levels of public expenditure are desirable. This latter group will seek to fund higher levels of revenue expenditure through the use of the local taxing powers. The central government's counter to this is to impose restrictions on the use of these local taxing powers. It can do this in one of two ways. First, by some form of central control over rate levies (which is the policy it has adopted towards local authorities in Scotland). Second, by causing a gearing of property tax increases which will promote an electoral response. Alternatively it could proceed through a combination of both approaches.

But whatever policies do evolve, one central plank of central government control will still remain and that is cash limits. Traditionally the central government of the United Kingdom has used cash limits to fix the amount of grant aid which it pays to local authorities and the amount of capital investment they can undertake. These limits have not in the past been used to control the total of local authority expenditures. But even though cash limits on the grant could be a significant factor in influencing the expenditure of local authorities, for a number of reasons they are not viewed as a strong enough weapon of control by the central government. These reasons include:

(i) The lack of predictability of the effect upon individual authorities.

(ii) The length of time necessary to achieve a response from local government as a whole to cash limits.

(iii) The inadequacy of the response the cash limits appear to be achieving, from the central government's point of view.

Consequently, a question which is currently facing United Kingdom local authorities is whether cash limit control should continue to be confined to grant aid only.

The central government is particularly concerned that even though local government in total has generally met central government's expenditure targets up to and including 1979-80, there are some signs of change. For 1980-81 and 1981-82 there has been a greater divergence than previously between likely spending levels and expenditure targets. And the political polarisation which is beginning to develop between central government and some large local authorities make the achievement of expenditure targets less likely.

These divergences from actual expenditure targets and the apparent weakness of an expenditure control system based upon cash limiting grant aid have persuaded the central government that other procedures are also required. For 1980-81, and after the grant arrangements had been settled, the central government announced that each local authority would have a target expenditure level which was a straight 5.6% below that authority's expenditure in 1978-79, in nominal terms. The government subsequently announced part way through the financial year (i.e. in June) that if authorities did not meet this expenditure target, they would suffer a penalty in the form of a loss of grant aid on a basis which was disproportionate to the basis announced at the time the grant was fixed.

These expenditure targets for grant penalty are quite separate from and unrelated to the falling shares of expenditure financed by grant aid as expenditure rises above the predicted figure for each authority derived from the grant distribution formula. The reason for the decision to use separate penalty targets was that the actual expenditure of many authorities differed substantially from the predicted level of expenditure using the grant formula and it was felt that the penalty system had to relate to the authority's own expenditure performance.

But there are also problems with this new system of control:

(i) The grant control is cash limited and therefore adjusts for inflation whereas the penalty target is not cash limited and therefore does not adjust for inflation.

(ii) Apart from inflation, there is no relationship between the expenditure target for grant distribution purposes and the expenditure target for penalty purposes.

Moreover, both systems of control are arbitrary and the more detailed the application of the systems becomes, so does the degree of arbitrariness in the national totals of expenditure, in the allowances for inflation, and in the allocation of those national totals via the grant system to individual local authorities. This is a cause of much political argument and is a reason why some local authorities find the operation of the system increasingly irksome.

An interesting consequence of the unpredictability of the grant system, the arbitrariness of the cash limit system, and the arbitrariness of the penalty system is that local authority effort has become diverted to a concern for ways of manipulating the system (particularly by political pressure) to maximise grant aid rather than the control of the underlying level of expenditure. Because of the emphasis on targets nationally and particularly at the individual authority level, with the added system of penalties, the general picture of events as seen from the local government point of view is one of increasing centralisation of key decisions, an ironic development for a conservative regime. What is more, local governments fear that the recent trend to miss expenditure targets and the growth of political polarisation may accelerate the move towards centralisation.

THE PROBLEM OF CONTROL

Accountability

One obvious explanation for the development of cash limits and penalty systems is that local government expenditure has grown too big and is not responding to a decline in national wealth because there are no adequate arrangements for checks and balances at the local government level. There is, for example, no mechanism to require a local authority to seek specific electoral approval every time it wishes to increase its local tax rates. But in fact a key problem is that even if such a system of electoral check were introduced, it might not work very efficiently for the simple reason that the percentage of expenditure of local government paid for by those who vote is extremely small. Less than 17% of the cost of local services is borne by local taxpayers who have the right to vote and, of them, only one third actually turn out and vote. And the impact upon this 17% is diluted further by a system of rate rebates and facilities for easy payment. To put the point another way, nearly 85% of local authority expenditure comes from people who have no electoral say in how the money is spent. The insulation of expenditure decisions from voters is the result of longstanding trend increases in grant aid and modifications of the franchise to remove the 'business vote'.

A second perspective on the decline in local accountability can be seen from the share of local taxes as a proportion of disposable personal income, shown in Table 1. Local tax revenues as a proportion of personal disposable incomes have still not reached the levels of 1938/39. What is more, since 1967 and extended in 1974, the rebate

Table 1 Rates as % of Personal Disposable Incomes

	Percent
1938/39	2.71
1955/56	1.92
1965/66	2.57
1975/76	2.09
1979/80[a]	2.22

[a] Estimate.

Source: 'Public Money', CIPFA.

schemes for the lower income group have reduced the real impact of the local tax even more.

The central government sees lack of accountability as a major weakness, and as a consequence high spending local authorities are not viewed as having a political mandate to continue spending at high levels even though they may win a local election. What also becomes an argument is that lack of accountability causes local authorities to be less resistant to the effects of inflation, i.e. they would be more likely to submit to high wage demands rather than suffer the effects of work stoppages. The electoral consequences of work stoppages are more damaging than the cost of high wage settlements. Work stoppages prevent the delivery of services, i.e. remove by up to 100% of the benefit of the services, whereas inflationary wage settlements only have an impact upon the local ratepayer to the extent of about 17% of the cost. Similarly lack of accountability means that the pressure to increase efficiency does not exist, or is limited. Again it is convenient to continue with existing working practices or to employ more labour rather than search for improved methods of working to achieve a greater volume of output.

Because of this apparent insulation of fiscal decisions from voting in local elections, high rate increases are unlikely to have such an impact upon the local electorate. Again this becomes another argument for central government to deny the existence of an effective local mandate and hence to use controls like cash limits targets and penalties to curtail the spending of both local government in total as well as of individual authories.

This issue of accountability is central to the long-run survival of United Kingdom local government. To solve it would mean changes in both financial and organisational structure, yet neither is likely to occur within the next few years. For this reason in the United Kingdom the likelihood is that the relationship between central and local government will tend to develop in a manner which allows central government to dominate the relationship using its arguments about the national needs to contain public expenditure.

Efficiency

The weakness of the relationship between paying and voting, and the probable adverse effects upon the efficiency of local government has been used implicitly but not explicitly as one argument justifying the use of cash limits. If electoral pressure cannot create the climate to improve efficiency, then cash limits on capital expenditure and on grant aid should.

There is some evidence that local authorities have become more concerned with efficiency since cash limits were first used, and particularly since 1979 when the central government took a more stringent attitude towards the relaxation of cash limits to reflect unforeseen inflation. But for this purpose cash limits are a relatively crude weapon and the central government has attempted to create pressures to improve efficiency by the use of other tactics.

It now requires (although the arrangement is presently regarded as 'voluntary') that local authorities publish locally certain key statistics about their performance. A difficulty with this approach is that performance in many areas of local authority activity is difficult to define and, even if capable of definition, is subject to many influences outside the control of the authority such as the demographic and social structure of the population. These factors too are reasons why the grant distribution arrangements and the system of targets and penalties is crude and hence relatively arbitrary in its operation.

The central government is also encouraging local authorities to employ consultants to advise them on methods of improving efficiency. The external auditor has been put under pressure to pay greater attention to questions of efficiency and effectiveness. Finally the central government has introduced legislation which for certain activities will introduce more private sector competition and will also give to the central government power to require the closure of the activity if the authority is not achieving a specified rate of return on its investment. These activities include housing construction, housing maintenance, and highway maintenance. If the local authority activity were shut down, the authority would have to employ private contractors to erect new dwellings, to maintain its stock of dwellings, and to maintain its roads. Some local authorities operate in this way now quite voluntarily. The recent legislative powers impose specific performance requirements whereas previously the choice lay almost entirely with the local authority.

Recent pressures to improve efficiency have led to some use of private contractors in other areas. There has been one well-publicised case of refuse collection being handed over to private enterprise, but so far the impact of privatisation has not been great. What is more, given the capture of local authorities by political opponents of the central government any voluntary trend towards privatisation could cease.

But cash limits have created a second reason to use private sector resources. The now extremely tight limits of capital investment by local authorities have caused a search for ways in which private capital can be employed to create the investment which a local authority wishes to see. The private sector will obviously only invest where it can see a commercial rate of return and the main thrust of this alternative investment has been into commercial and industrial property development including car parking, and into some recreational activities.

The cash limits on capital investment have one important 'loophole' which will affect efficiency. The only significant way in which the cash limit can be stretched is by using capital receipts generated from the sale of assets. So the existence of this 'loophole' will encourage local authorities to increase their concern about the efficiency with which physical assets are used.

A major component in the argument about efficiency is providing services of the type, style and scale which the consumer wants. The inadequacies of the accountability arrangements mean that electoral pressure is limited. The service arrangements tend therefore to become dominated by the attitude of professional experts supported by the relevant pressure groups. The thrust is inevitably for expansion because the consumer wants for example more and better education and social services, more cheap housing and better roads. He may not be able to articulate how he wants the service delivered, but there is no evidence that he wants it reduced, nor is it reasonable to expect that he should, given that he contributes directly so little to the cost. Social surveys in the United Kingdom have shown that even given a decline in national wealth, maintenance and improvement of public services is seen as desirable.

CONTROL BY CASH LIMITS

Operating Cash Limits

Cash limits now operate directly on capital expenditure but only indirectly on revenue expenditure. Control of capital expenditure before 1981 was based upon controlling borrowing, and expenditure financed by methods other than borrowing was largely excluded from control. Nevertheless, the control of overall capital investment was relatively effective. Again before 1981 the cash limits on grant aid affected the national totals of grant aid and there were no spending targets for individual authorities. Since 1979 the cash limits on grant aid have progressively become more rigid in their method of operation.

The central government has tended to prefer reductions in new capital investment by local authorities to reduction in existing services, although that is now changing. From its point of view there were fewer political difficulties. What is more, because of the tight system of control, it could actually force down local authority capital investment and in addition use it as a regulator if the cash-limited grant system failed to control revenue spending. The resultant differences in trends are shown in Table 2.

The brunt of the cuts during this period has fallen on capital expenditure, though the present government, since 1979, is clearly seeking substantial cuts in current expenditure too.

Table 2 Trends in Local Government Expenditures, 1975/76 to 1981/82

£m 1980 survey prices

	1975/6	1976/7	1977/8	1978/9	1979/80	1980/1	1981/2
Current expenditure	16601	16484	16427	16911	17301	16718	16112
Index 1975/6=100	100	99.3	99.0	101.9	104.2	100.7	97.1
Capital expenditure	7667	6412	5114	4515	4461	3432	3088
Index 1975/6=100	100	83.6	66.7	58.9	58.2	46.1	40.3

Source: Table 1.10 Cmnd. 8175.

Table 3 shows how local authority revenue expenditure financed from rate and county funds of local authorities in England and Wales has compared with central government targets, set out in annual public expenditure surveys, over the period from 1975/76. This is not the total of local authority expenditure because it excludes a number of items such as capital financing charges. But for public expenditure control purposes these are the figures on which central government focusses attention.

Table 3 Local Authority Current Expenditures Compared to Target Levels

£m at November price base

	Expenditure target £m	Actual expenditure £m	Deviation (actual-target) %
1975/76 (Nov. 1975 prices)	8,610.4	8,754.5	+ 1.7
1976/77 (Nov. 1976 prices)	9,818.5	9,741.9	- 0.8
1977/78 (Nov. 1977 prices)	10,709.8	10,423.4	- 2.6
1978/79 (Nov. 1978 prices)	11,923.4	11,738.4	- 1.5
1979/80 (Nov. 1979 prices)	13,853.6	13,748.9	- 0.7
1980/81 (Nov. 1979 prices)	13,310	13,690	+ 2.9[a]
1981/82 (Nov. 1980 prices)	16,125	17,025	+ 5.6[a]

[a] latest estimate.

Sources: (i) Annual Rate Support Grant 1975/76 to 1979/80. Local Authority Association.

(ii) Summaries of local authority forecasts for 1980/81 and 1981/82.

The conformity to central government wishes in the early part of the period, i.e. up to 1979/80 is perhaps surprising because of the lack of direct control by central government over local authority current expenditure. The total expenditure figures are the result of independent decisions by the 457 individual authorities.

These results for current expenditures can be compared with those for capital expenditures, given in Table 4.

Table 4 Local Authority Capital Expenditure Compared to Target Levels

	Expenditure target £m	Actual expenditure £m	Deviation (actual-target) %
1975/76	7,025	7,667	+ 9.3
1976/77	6,225	6,412	+ 3.0
1977/78	4,775	5,114	+ 7.1
1978/79	5,085	4,515	-11.5
1979/80	5,425	4,461	-18.2
1980/81 (est.)	3,795	3,533	- 7.3
1981/82	3,090	n/a	

Note: The figures of public expenditure targets in the table are approximate only.

Source: Government Expenditure plans 1981/82-1983/84 Cmnd 8175 and earlier white papers.

Tables 3 and 4 bring out two important points. First, up to 1979/80 local authority current expenditure target levels were rising, and actual expenditures usually fell short of this rising target. Since 1979/80 expenditure targets have declined rapidly, and it is in these two years that important divergences have started to occur. The question facing central and local government is whether or not targets can be so readily met in a period of decline.

Secondly, local authority capital expenditure has fallen very sharply, both in level terms and relative to targets. This reflects the central government's very tight control over local authority capital investment and the political expediency of cutting capital investment rather than revenue. The developing squeeze on local authority revenue expenditure has had the effect of discouraging local authorities from embarking on new capital investment programmes even where they may have available spending approvals because they have become reluctant to commit new investment because of the added burden it would place on scarce revenue resources. But what has happened does then raise important questions about the relationship between capital investment and revenue expenditure and in a sense about the efficiency of the disposition of local resources. If, for example, the relationship was right in 1975/76, it is clearly not right for 1980/81.

Implicit in any cash limit system is an assumption about inflation. In the United Kingdom so far as local authorities are concerned the cash limit control on inflation affects all price movements other than interest rates. The allowances for inflation set in each of the years since the cash limit started to operate have been as follows:

Table 5 shows that during the first year of cash limits, 1976/77, grant payments were restricted.

Table 5 Original and Inflation Adjusted Increases in Grants, 1976/77 to 1981/82

	Original increase of cash limit on grant %	Actual increase in grant %	Increase in costs %
1976/77	6.9	6.4	9.4
1977/78	8.0	5.6	5.6
1978/79	6.9	8.6	9.0
1979/80	6.0	10.6	16.0
1980/81	16.0	n/a	more than 20.0
1981/82	6.8	n/a	(9.3)

Source: Local Authority Associations.

In 1978/79 and 1979/80 the limits were amended to take account of higher than expected inflation, but not all additional costs resulted in additional grants. There is, at present, no indication that the limits will be raised for inflation in 1980/81 and 1981/82, even though inflation is expected to be greater than the amount anticipated by the central government in forming its original limits. Hence the central government attitude to the cash limit has become more stringent recently and this coincides with a change in the political control of the central government from a left wing to a right wing government.

Because the cash limit effects are not fully adjusted for inflation, any excess inflation falls wholly on to the local authority. There is obviously a "gearing" effect on local authority rates or precepts because of this. On average, this gearing effect means that every £1 excess inflation, which would otherwise be financed 60p from grant and 40p from ratepayers, has to be recovered wholly from ratepayers, with in practice less than half from voting ratepayers.[2] The pressure on the central government is of course to fix the allowance for inflation at the lowest possible level and hence to use the pressure consequently generated to influence local government's response to inflationary pressures, particularly pay demands.

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[2] The procedure for fixing the amount of cash limited grant aid is that the central government fixes grant aid on the basis of the November price level preceding the relevant financial year (which runs from the following April to the subsequent March) and at the same time announces the limits to which it is prepared to increase grant aid to meet inflation accruing from the November date to the end of March in the relevant financial year, i.e. 16 months later.

However, local government's attitude to the cash limit is different from central government's. Fundamentally the central government is concerned with the management of the economy, and its attitude to cash limits will be influenced by that consideration. Local authorities have an entirely different concept. They are concerned with cash flow control and they may make a judgement about the effects of inflation which is different from the central government's. Given this, local government may assume higher cost increases than central government and this may make the grant settlement appear less generous than the central government envisages. Which in the event is the correct view will depend entirely upon the final actual expenditure calculations for the relevant year.

There is an argument of course that local authorities should adjust for excessive inflation by reducing the underlying volume of expenditure. To a limited extent they may do this, but there are important practical reasons why this is not very easy, or indeed why it is not seen as desirable. First, local authorities view the government's forecasts of inflation with suspicion. Where they appear obviously low they tend to see this as an attempt to cut the volume of expenditure in a disguised (i.e. more politically attractive to the central government) kind of way. They may not be willing to co-operate because they have to take the political responsibility for what they see as the covert action of the central government.

Second, 25% of local authority expenditure is devoted to one item: teachers' salaries. So if major reductions in expenditure are to occur, the teaching labour force has to be reduced. The difficulties with this are that teachers' conditions of service frequently allow for 6 months or 12 months period of notice or at a minimum a complete term. So the earliest time teachers can be dismissed is from the following September and this means that, as this is half way through the financial year, twice as many teachers have to be dismissed merely to stay within an expenditure limit, as is really necessary. Where the period of notice is longer than a term, this problem is compounded.

Third, most local authorities do not prepare their management control budgets on a cash basis; they normally prepare them on a real basis. The procedure is for local authorities to prepare their budgets at November prices and to keep a central reserve to finance inflation as it occurs. Budgets are crucial to line managers in November price terms but of course the actual price level is moving away from this price level all the time because of inflation. Management therefore has great difficulty in knowing how far budget variances are due to price or volume changes. Attempts are now being made to overcome this problem by more sophisticated financial information systems and by the use of cash limit techniques by the local authorities themselves to control actual cash outflows.

Fourth, most local authority employee pay settlements are fixed centrally. The local authority feels it has to pay whatever is agreed centrally and it would be under very strong trade union pressure should it attempt to offset higher pay levels by reduced staff. Local authorities in the climate of the latter part of the 1970s found it very difficult to resist concerted trade union pressure. It is probably less difficult now.

Fifth, local authorities controlled by left wing inclined political groups might not see any particular reason to resist higher pay levels. This is particularly so when they are suspicious of central government motives in the fixing of inflation forecasts. And the local authorities willing to make cuts in the labour force to compensate for higher pay levels are certainly unwilling to overcompensate for the 'deficiencies' of other local authorities.

Sixth, to make a system of cash limits work at the local level requires a very strong local political control which quite obviously cannot always exist. Even if the political personalities exist the controlling political group's majority may be inadequate to support such a policy, particularly when the local consequences may be perceived to be socially adverse.

Seventh, because of the imprecise relationship between central and local government coupled with what is seen by local government as the vagaries of the grant distribution system (see the sections below on the new grant system) higher rate levies can to some extent be blamed on central government. This is a deficiency in local accountability.

Fixing Expenditure Targets

Local authorities are independent bodies and they are not agents of the central government. How much discretion they actually have in determining the size of services is a matter of debate but the legislation granting powers to local authorities to provide services is couched in the broadest terms. So in theory, local authorities have potentially a very wide discretion.

Local governments are not parties to the central government decisions on acceptable levels of public expenditure. They act as a pressure group and explain to central government the implications of its decisions. The central government reaches its own decisions based upon its own political and economic judgements.

Although local governments are not parties to the central government's public expenditure decisions, a forward review of local authority expenditure including the likely result for the current year is carried out by joint teams of central and local government officials. These forecasts may contain the effects of adopting alternative strategies. For example officials might be asked to examine the effects of reducing expenditure in forward years by, say, 2.5% and 5% and 7.5% below the current levels of service. These effects will be taken into account by the central government in making its decisions about the total local government expenditure levels which it wishes to see and which it incorporates into its public expenditure plans, as well as the amount of grant aid which it is prepared to make available to local government.[3]

The principle problems with the new system of capital controls in operation from 1981 are the arbitrary nature of the distribution of the capital expenditure allocations to the authorities and

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[3] There is also another forum for dialogues between the central government and local governments, the Consultative Council.

the virtual elimination of any opportunity to modify the worst effects of this arbitrary distribution by the use of local revenues. This could be done with the previous system when control was on borrowing only.

The capital expenditure allocation distribution formula relies on two factors: population and past capital expenditure. Neither are good indicators of future investment plans. So local authorities perceive this form of expenditure control as arbitrary and inconsistent with local needs. The question which will have to be debated in the United Kingdom is how far arbitrary expenditure control should be used to suppress all local discretion in investment decisions and how local discretion can be coupled with a central desire to control the totality of public expenditure? Is absolute control that important?

REVENUE EXPENDITURE CONTROLS

The evidence of Table 3 shows that local authorities are finding difficulty in reducing current expenditures in line with the central government's targets. And as the likelihood is that public expenditure still will be in decline for the next two years, pressures upon local authorities will grow.

The central government has expressed concern about local authority expenditure and its lack of ability to influence the spending of individual authorities. The Local Government Planning and Land Act 1980 was introduced to give the central government ability to influence current expenditures more effectively, and in particular to influence the expenditures of individual authorities. But that legislation appears to be inadequate, and a number of alternative policies are now being considered. These are discussed in a later section.

The system of control in operation since 1981 allows the central government to set expenditure targets for each authority. These targets can be in volume terms, or cash terms, or both. The grant payment to a local authority depends upon an expenditure target being set and if the actual expenditure of the authority is in excess of the target, grants can be reduced. So authorities that spend above the target can be specifically penalised, instead of having the penalties fall on local government as a whole as was the case with the previous system. The new system focusses the penalties and might therefore be regarded as more equitable -- certainly the previous system was perverse in that up to a point the more an authority spent the more grant it could get in some circumstances. Clearly a critical consideration if the system is to work well is the setting of expenditure targets for individual authorities.

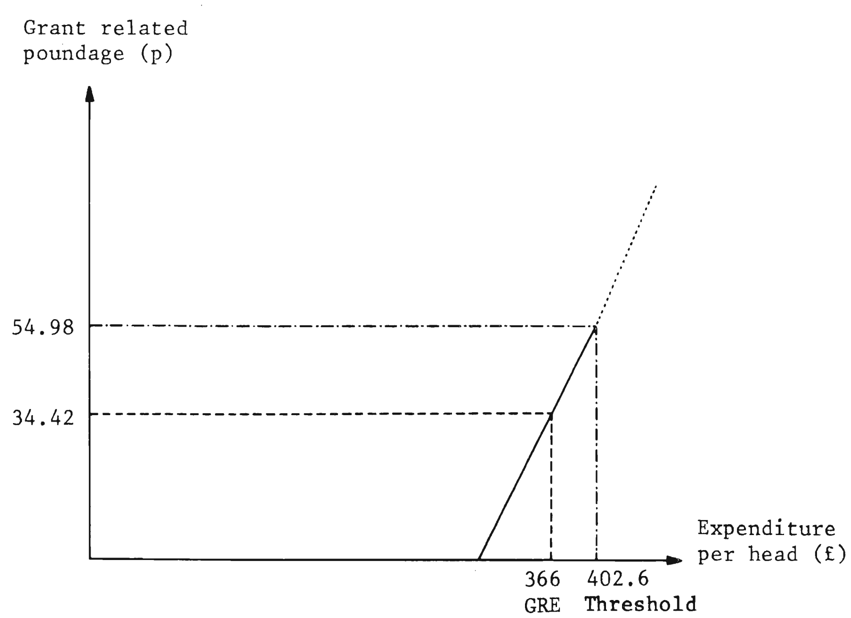
The Mechanics of the Block Grant System

The basic objective of block grants is to equalise the rate poundage required by each authority to spend at the level of its "grant related expenditure assessment" (GRE). This is the government's view of what each authority needs to spend to provide a standard level of service. Should an authority choose to spend at this level, its block grant will be the difference between this expenditure and the income it would derive from levying the "grant related poundage" (GRP) for expenditure at GRE.

Expenditure below GRE reduces the GRP by a fixed amount for every £1 per head of population it is below GRE; expenditure above GRE entails an increase in GRP for every pound it is above GRE. This poundage tariff for extra expenditure is constant, and at the same level as that for expenditure below GRE. Above a threshold (which is the grant related expenditure plus 10%) there is a once for all increase in the poundage tariff for additional increments of expenditure. (But it does not have to be a once for all increase and the central government could make spending above the threshold progressively more penal the higher the spending.)

The graph below illustrates the schedule of rate poundages which applies to each area. It can be seen that, in grant related poundage terms, as expenditure per head increases (a basic minimum

Figure 1 Grant Related Poundage as a Function of Expenditure per Head



grant is payable for most authorities), authorities face the same increase in poundage until their level of expenditure reaches the "threshold" level. There is a once for all increase in the marginal poundage cost of additional expenditure, which in 1981/82 raised the cost of an additional £1 per head expenditure from 0.56p to 0.70p.

The basic mechanism is modified in some cases by the use of a multiplier. Multipliers are used for a variety of purposes, e.g. to prevent full equalisation of resources between London and the rest of the country, to operate a safety net on grant losses and a ceiling on grant gains. By law the principles by which a multiplier is determined must be specified in the statutory instrument specifying the details of the grant system and must apply to all authorities of a particular class. A multiplier modifies the assumed income derived from levying the appropriate grant-related poundage used in calculating the block grant entitlement thus:

Block grant = total expenditure - (GRP × rateable value × multiplier)

Thus a multiplier of less than unity increases the block grant entitlement; a multiplier of more than 1 reduces it. Multipliers can only be used to reduce the grant entitlement of an authority where the grant gain to that authority would otherwise be excessive, i.e. to implement a ceiling on grant gains.

For 1981/82 the poundage schedule has been set with a total grant-related poundage for expenditure equal to GRE at 34.42p. (This is split between the tiers of authority in an area, i.e. one for county councils and another for district councils.) For expenditure below GRE, GRP is reduced by 0.5618p for each £1 per head of expenditure. Above the threshold, GRP increases by 0.7023p for each additional £1 per head expenditure.

The threshold is set at £36.60 per head (10% of the average GRE of £366) and again this is split between tiers of authority. The fixed cash threshold means that the threshold represents a lower proportion of GRE in high need areas than in low need areas.

The effect of the poundage schedules in cash terms on an authority's grant entitlement depends entirely on its rateable value per head as modified by the multiplier -- RVm. Authorities with differing RVm face very different incentives in terms of grant cash. How this arises can be shown by looking at how block grants per head are calculated:

$G = E - (GRP \times RVm)$,

where G = grant per head and E = expenditure per head.

An increase in expenditure of £1 per head, (assuming this keeps expenditure below the threshold), causes an increase in GRP of 0.5618p or £0.005618. Let the extra grant attracted be ΔG.

Then $\Delta G = 1 - (0.005618 \times RVm)$.

For grants to increase, the rateable value per head modified by the multiplier must thus be less than £1:0.005618 = £178 (see as an example of this Figure 2 below showing the effect upon Wandsworth).

If total expenditure is above the threshold then GRP increases by 0.7023p for each £1 per head increase in expenditure. In this case the increment of grant will be positive for additional expenditure only if the modified rateable value per head is less than £142.

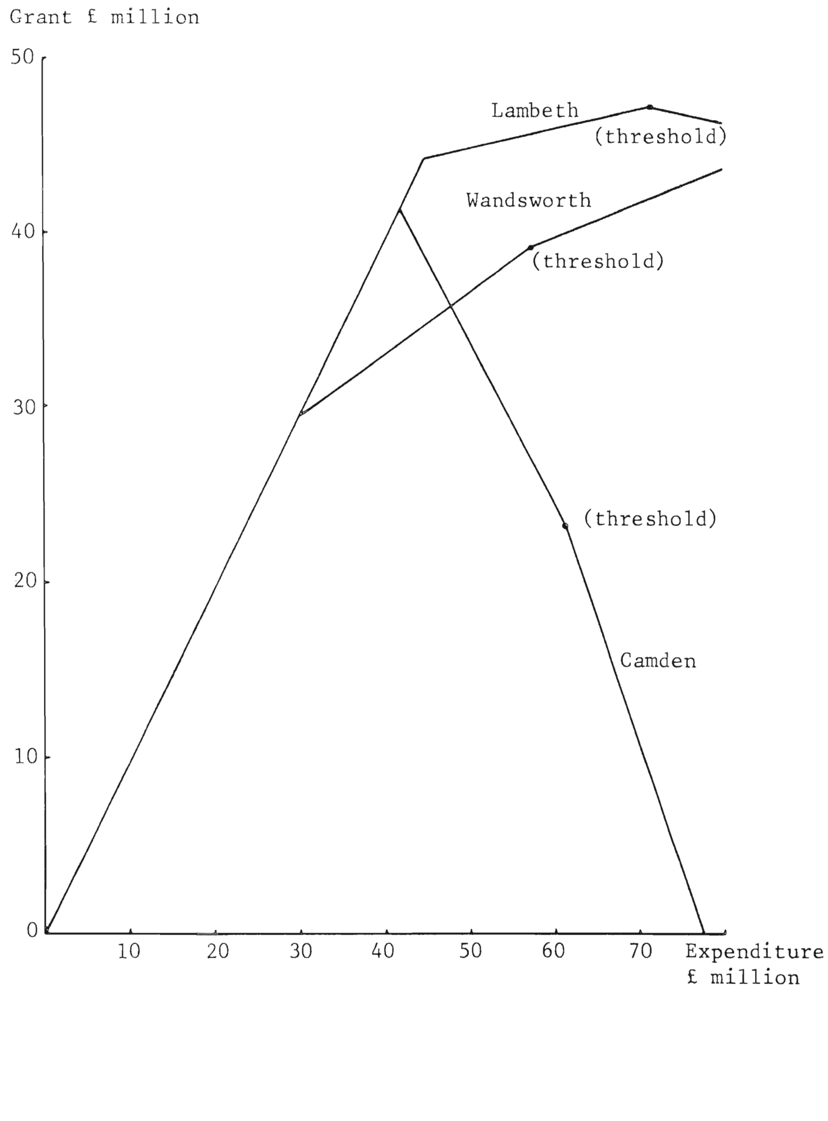
The effect of this in grant terms has been illustrated very clearly by Travers in his paper "Block Grant Distribution in 1981/82". He shows how a number of high resource authorities, principally in London, would receive more grants the less they spend, even below the level of GRE (to the point where all expenditure is met by grant because GRP is zero). These are authorities for whom RVm > £178. For a number of authorities with slightly lower RVm's, e.g. Surrey, Lambeth, where £142 < RVm < £178, the maximum grant is obtained if expenditure is at the level of the threshold. Thereafter grant decreases as expenditure increases. For the vast majority of authorities, however, grant continues to increase, even above the threshold. This is illustrated by the three graphs in Figure 2, prepared by Travers.

In the case of Camden, up to expenditure of £41.5m, grant pays fully for this authority's expenditure. Once this point is reached grant reduces in absolute terms, more steeply once the threshold expenditure is reached.

In the case of Lambeth, all expenditure for the authority is financed by grant up to £44.5m. Above this level, grant increases with spending, but only covers a certain proportion of costs. After the grant threshold at £72m expenditure the grant falls in absolute terms as expenditure increases.

The Wandsworth authority, which is typical of the majority of authorities, receives grant on a £1 for £1 basis up to £30m expenditure. It then continues to receive additional grant aid as expenditure increases, although not on a one for one

Figure 2 Grant Receipts at Different Expenditure Levels 1981-1982 for Camden, Lambeth and Wandsworth



basis, and once the threshold is reached the marginal support from grant is further reduced. But the total of grant aid continues to rise.

In practice, even this complex system has additional elements of imprecision:

(i) the grant calculations although initially made on the basis of estimated expenditure are finally determined on the basis of actual expenditure and actual expenditure may not be definitely known until after the completion of the audit of all local authorities some two or three years after the initial calculation.

(ii) local authorities tend to budget for more than they can achieve and this apparently draws in more grants. But the grant is cash limited so when all the budgets have been summarised 'over budgeting' results in a proportional reduction in grant aid.

(iii) some local authorities may be willing to accept lower grant proportions when they spend above the threshold anyway. This draws grants into those authorities and reduces the grant to all other authorities because the total is limited. So high spending by some authorities actually reduces the grant aid to others. The extent of this cannot be forecast by an authority when it fixes its budget and rate levy.

(iv) these uncertainties cause local authorities to add to their reserves. This increases expenditure for grant calculation purposes and this of itself causes a redistribution of the grant after the initial budget and rate has been fixed.

Targets and Penalties

Superimposed upon the grant system is a system of volume targets quite separate from the GREs. These spending targets are based upon each authority's final 1978/79 expenditure, in current prices, less 2% for 1980/81 and 5.6% for 1981/82.

The whole ethos behind the volume targets is quite different from that of the GREs. The GREs are the government's attempt -- though an attempt which can be criticised on numerous grounds -- to prescribe the expenditure required to provide a standard level of service in each authority. They inevitably carry normative overtones -- that they represent in some sense the 'right' level of expenditure, at least in the government's view, for each local authority. Indeed, the whole system of grant penalties under the block grant system is based on divergencies of actual expenditure from GRE.

The volume targets, on the other hand, carry no such 'normative' connotations. They cannot represent a government view of the 'right' level of expenditure since they are based on each authority's own actual expenditure for 1978/79. The actual expenditure level is the outcome partly of each authority's own expenditure decisions in 1978/79 and partly of chance factors which affected those decisions during the year. Not surprisingly, therefore, the volume targets issued to individual authorities differ quite markedly from the GRE assessments in many cases.

To the outsider the use of two target figures seems very confusing. The logic is that the GREs were somewhat crudely defined and the central government's view, adopted after criticisms of the GREs by local authorities, was that it would be unfair to put too much weight on them. The government is concerned to see local authority revenue expenditure contained within the national forecast levels included in the public expenditure survey. The block grant system using indirect controls is not achieving the targets required. The central government wants to impose more severe penalties on high spending authorities and the imperfections of the GREs have prevented it using them for penalty purposes. Hence the volume targets were based upon an authority's own spending levels. But local authorities have found the system confusing and inconsistent and this confusion has contributed to the failure to meet expenditure targets. The two targets will be related for grant penalty purposes. If an authority is spending above its GRE and therefore should lose grant under the block grant rules it will be excused from further penalty if it has met the second volume target. And vice versa.

Table 6 below shows how authorities have been set conflicting targets and illustrates that they have reacted in different ways. The top four authorities are all over their GRE, but two have increased expenditure and two have decreased (even though only one is below its volume target). The bottom four authorities are all at or below their GRE, but two have increased spending and are above their volume target, while the other two have decreased spending, being at or below their volume target.

These targets based upon 1978/79 can be criticised from a number of angles apart from the inherent threat they represent to local authorities' right

Table 6 Volume Targets and Actual Spending in Eight Local Authorities

Name of authority	Difference between spending and GRE %	Difference between spending and volume target %	Difference between latest budget and previous year's revised budget %
Hackney	+ 40	+ 6	- 17
Wandsworth	+ 20	- 14	- 14
Camden	+ 76	+ 24	+ 6
Sheffield	+ 29	+ 11	+ 5
Cornwall	- 2	+ 9	+ 1
Devon	0	+ 7	+ 1
Solihull	- 4	- 1	- 2
Trafford	- 4	0	- 4

to make their own decisions on the level of revenue expenditure. At a technical level 1978/79 did not represent, for many authorities, a typical year. A severe winter, a manual workers' strike, a strike by social workers in some authorities, and other disruptions to supplies caused by, for example, a lorry drivers' strike, markedly affected the authorities' expenditure during that year. Moreover, the advanced further education "pool" arrangements were changed in 1979/80, redistributing the burden of expenditure and significantly increasing the contributions of many authorities. Those local authorities which had made major cutbacks before and during 1978/79 felt they were being unfairly penalised compared to those which had not. In any case, the choice of any one year is inevitably entirely arbitary and would always give rise to anomalies.

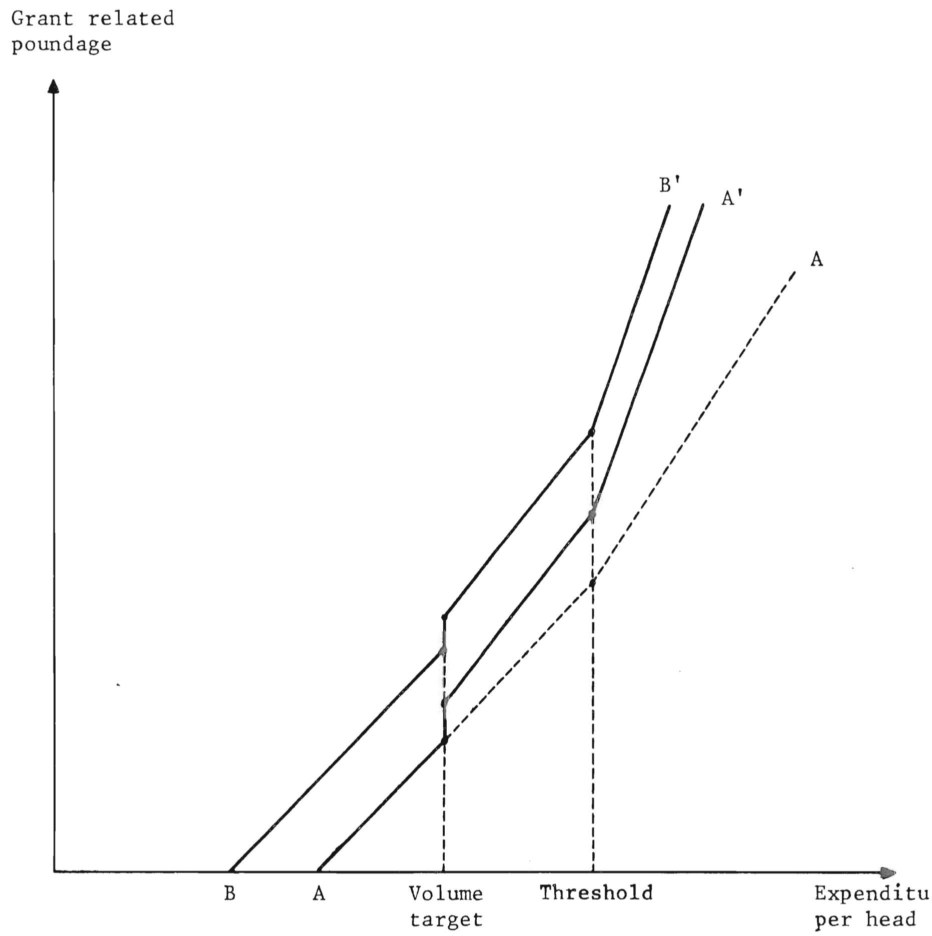
These factors though are an important reason for the divergence of the targets from the GREs.

Volume Target versus GRE

At the national level the two sets of controls designed to influence the revenue spending of individual authorities, i.e. the GREs and the volume targets give the same result. But to the individual authority the perception is different. The grant calculation and the penalties which flow from failure to meet the targets are also inconsistent. The relationship has been described earlier. The penalty system does not follow the grant expenditure relationship in three respects. First, it does not flow logically from the grant system; the national sum involved in the penalty is arbitrarily determined by the central government. Secondly, the distribution of the penalty over authorities falls differently from the distribution of the grant/expenditure profile over authorities. In other words the penalty can be used to exact a higher cost from some authorities than the grant system does. Thirdly, because expenditure is defined in a different way in volume targets than in GRE an increase/decrease in one measure does not necessarily imply an equivalent change in the other measure.

The penalty with the target system is an increase in the poundage schedule for grant purposes for local authorities spending above the target. This reduces the amount of grant each of those authorities receives (but of course for some authorities who because of the rateable value effect receive nil or very small amounts of grant the practical penalty is nil or very small.) The penalty will increase the marginal poundage cost of $1 per head additional expenditure from 0.56p below threshold and 0.70p above threshold, to 0.6p below threshold and 0.75p above threshold. Some limited protection is provided for authorities only slightly over their target expenditure. This means that in Figure 3 below an authority which had faced a poundage schedule AA, but is spending above its volume target, now faces a poundage schedule AA'.

Figure 3 The Effect of Grant Penalties and Cash Limits



If that authority reduces its expenditure to less than its volume target it reverts to its original schedule. There is a step in the schedule at a particular level of spending, corresponding to the volume target. Because there is no relationship between volume targets and GRE, this step can occur anywhere, depending on individual circumstances.

To these penalties may be added a once for all shift of the schedule from AA' to BB' if it becomes clear that the authorities in aggregate have been claiming more grant than what is allowed by the cash limit.

Calculating the GRE

The calculation of GRE concentrates on ways of relating spending need to the average costs of providing services for each 'client' in need of them or each 'unit' of service provided. The assessments are built up on a service basis, with services grouped into four main categories. Group 1 contains services provided by the major spending tier in each area, Group 2 services provided by counties only, Group 3 services provided by district councils only and Group 4 concurrent and miscellaneous services. Individual authority's assessments are made by amalgamating appropriate factors from these groups. Allowance is made for higher input costs in certain areas, and for the higher costs associated with certain demographic features, such as sparsely populated areas.

The new system however does give some substantial cause for concern. For example, one area of major concern within the GRE assessments is the allowance made for cost differences between areas. The only allowance included (apart from small adjustments for sparsity of population in some formulae), is for higher labour costs in London, though it is doubtful whether the allowance is sufficient to represent the full effect of high labour costs in the capital. No allowances have been made for possible higher labour costs elsewhere and no allowances at all have been made for the differing costs of other inputs, e.g. rents, rates and other land costs.

Perhaps the most contentious area of the GRE assessments are the "unit cost" approaches adopted for education and the social services. Both these approaches are based on establishing the units of service of various sorts required to provide a standard level of service in each authority and costing these out at an average cost. Two examples can highlight the major problems associated with this sort of approach.

(i) It is widely recognised that some children require additional educational help which costs extra. How is a decision made about how many children there are in need of such help in each authority? The Department of Education and Sciences (a central government department) suggested 6 factors:

(a) children not U.K. born, or born to immigrant families

(b) children from large families

(c) children from one-parent families

(d) children from families of low socio-economic group

(e) children from overcrowded housing or lacking basic amenities

(f) children receiving free school meals.

Disregarding the question of whether these are the right factors, what is the relative importance of the factors? Does it really cost as much extra to educate a child from a family of category (d), as a child from an immigrant family who perhaps speaks no English (category (a))? The Department of Education and Science (DES) representative thought not; they recommended an option which would have given double weight to factor (a) compared to each of the other factors. It is ironic that the final GRE option selected by the government was not the option which incorporated the DES's view, but one which gave equal weight to all six factors, significantly disadvantaging a number of London boroughs and ILEA. It is interesting to note that DES views on other aspects of the education GREs, notably nursery education, were also ignored in the final selection of a GRE formula by the government. No reasons for the government's alternative choice have been given but the presumption must be that the choice was made for political reasons concerned with which authorities would gain grant and which would lose grant by the choice. As the GREs are a basis for defining "overspending", particularly for payment of grant, judgements such as this do tend to cause scepticism about the system on the part of some local authorities, particularly those adversely affected.

(ii) The number of potential clients for social services, e.g. services for elderly people, was postulated, on the basis of historical survey data, to be related to various social factors in each area, e.g. the number of elderly people living alone. It was then assumed that each potential client required the same average service levels, which could be provided in each area at an average cost.

> But is it really reasonable to assume that an elderly person living alone in a small rural community requires the same services as an elderly person living alone and isolated in a rundown inner city area? Equally, the GRE assessments for a large group of miscellaneous social services -- for the disabled, the mentally ill, the mentally handicapped etc. -- were made pro rata to population on the grounds that the proportion of disabled people, the mentally ill, etc. is not thought to vary much across the country. But the cost of providing services may certainly vary according to the degree of family and community support provided in, say, a small rural or affluent suburban community compared to an inner city area. The fact that the GRE assessments for social services seriously understate social services expenditure in all the Inner London boroughs, (including authorities which have permanent Conservative majorities), lends support to this view. (Even Department of Health and Social Security (DHSS) officials conceded that the London boroughs' assessments were not thought plausible by their social work colleagues in the Department).

From these GRE calculations the logic of a 'right' level of spending in cash terms and a definition of an 'overspender' for grant purposes emerges. The grant penalties in the block grant system operate on this definition.

Annually the grant distribution arrangements are reviewed and implicit in this review is a review of the GREs. However local authority criticism of the calculation of the GREs is inhibited by two factors. The first is that the local authorities cannot think of any better system without using regression analysis, which was tried once, did not prove very workable and is now discredited. Secondly the two broad groups of local authorities, the major urban areas and the rural areas, are quite divided in their approach to government. The result is that pressure for reform of the GREs is seen in the context of 'special pleading', i.e. will the reform cause gains or losses to a particular group of authorities. This inhibits abstract discussion of the merits of a proposal. All the negotiations with central government are at their root negotiations about power -- the distribution of power between the different types of authority and between local government as a whole and central government. Although the purist might deplore this approach, this is an inevitable consequence of the structure of local government in the United Kingdom, its system of financing with heavy dependence upon central government grant aid, and the inadequacies of the system of local accountability.

Problems with the Control System

There is some evidence from an analysis of the budgeted expenditure of local authorities for 1981/82 that reductions in grant aid does tend to reduce expenditure. But it is also clear that grant aid as a lever on expenditure works slowly and does not cause automatically a containment of expenditure to target levels, given the weakness of local authority accountability in the United Kingdom. This is the reason for the introduction of the system of targets and penalties.

But for any system of controls to work efficiently, the results must be reasonably predictable. Only in this way can a local authority see what every marginal extra £ of expenditure will cost. Unfortunately the system is not predictable. A first reason is that the very complexity of the GREs introduces elements of instability. Secondly, the statistical basis of the GREs is unreliable and that produces instability. Thirdly, the system of targets and penalties was introduced part way through the financial year and was itself inconsistent with the expenditure control implications of the grant system. Unpredictability has probably been one cause of a shift in the concern of local authority management from expenditure control to the seeking of ways of obtaining more grant aid. This is the opposite of what the controls are aiming for.

But there are other reasons why 'overspending' occurs and these include:

(i) the lateness of the grant and expenditure settlement (which is made in November/December).

(ii) the problems of making the required cuts quickly enough -- the scale of cuts required to reach GRE level (or even threshold, i.e. GRE +10%) for a significant number of authorities is such that it would be quite impossible to cut this far within a year (or even a longer timescale). There are for example problems of creating redundancies and this in itself is expensive because under United Kingdom legislation, compensation has to be paid when an employee is made redundant.

(iii) scepticism by some authorities of the objectivity of the GREs.

(iv) the use of GREs encourages some authorities to increase expenditure to GRE level while making it impossible for others to cut down to that level.

(v) inadequate allowance for inflation in the cash limit means authorities have to increase rates to meet the shortfall.

(vi) general uncertainties created by the block grant mechanism also encourage prudence in financing strategies, leading to higher rate increases because local authorities have decided to create reserves.

(vii) the swings in the distribution of grant aid. An analysis of attitudes to spending shows that generally receivers of a higher grant (i.e. than the previous year's grant) have increased spending or not reduced it, and losers of grant have tended to reduce expenditure but not in the same proportion as the loss of grant.

PUBLIC BORROWING AND THE MONEY SUPPLY

A critical consideration of the central government in making its decisions about public expenditure is the level of <u>the public sector borrowing requirement</u>. Local authorities contribute to that borrowing requirement either by borrowing from the central government to fund their capital investment, or by borrowing directly from the London money market. The local authority borrowing requirement is a substantial component of the total public sector borrowing requirement, as is shown in Table 7.

The public sector borrowing requirement as a whole is notoriously difficult to forecast because it is a residual item. The same is true of the local authority component of it. But central government decisions affecting local authority expenditure and cash limits are important in affecting the size of the local authority share of the public sector borrowing requirement. This is because of the effect on local authority balances or reserves. Stated rate or county fund reserves vary from year to year from £100m or £200m to as much as £1500m. But in addition to these stated reserves local authorities have other reserves set aside to fund capital expenditure, to renew equipment, to renew buildings, to meet insurance claims, etc. These reserves amounted to a further £600m in 1979. (England and Wales.)

Table 7 Public Sector Borrowing Requirements

	Total public borrowing requirements £m	Local authority borrowing[a] £m	Local authority borrowing share %
1975/76	10,582	2,472	23
1976/77	8,520	2,005	24
1977/78	5,594	1,492	27
1978/79	9,198	1,290	14
1979/80	9,914	2,981	30
1980/81 (est)	13,455	2,350	17

[a] Including borrowing from central government.

Source: Financial Statistics March 1981 HMSO and Financial Statement and Budget Report HMSO.

Local authorities fund themselves on a day-to-day basis by a combination of all cash inflows and outflows whether revenue or capital. As local government is a net borrower to the level of about £35 bn, their net cash position is usually one of being a borrower. They may use internal reserves to avoid external borrowing. If these internal reserves are used up and balances are run down because of, say, excess inflation, the need to fund external debt still remains and internal funding is switched to external and hence the local authority borrowing requirement rises. And, of course, vice versa.

From 1981-82 added restrictions on the uses of capital reserves will prevent their use to fund capital expenditure over and above any central government investment allocation and this should remove an element of volatility. However, a degree of volatility in the local authority element of the public sector borrowing requirement will still remain and attempts are being made to forecast more efficiently than can be done at present, how local authority decisions can and do affect this important factor in public expenditure planning.

An equally important consideration is the money supply. Local authority actions again cause the central government some concern because of the interrelationships between money supply, the public sector borrowing requirement, public expenditure generally, interest levels and wealth creation.

Local authorities borrow to fund their capital expenditure with about half their borrowing coming from the London money market. The central government is anxious to encourage local authorities to lengthen the life of their debt and local authorities now have to ensure that all new borrowing in a year has an average life of seven years.

A consequence of this lengthening of debt life, which started from about 1977/78, has been to cause local authorities to change the sources of their borrowings. Local authorities are now borrowing more money from banks and the result is that these borrowings affect the money supply in a way which a higher level of borrowing did not do in the past.

So whilst severe cash limits have reduced local authority capital investment the changes in the refinancing of existing debt caused by the effects of other central government policies have actually made local government's position more exposed so far as the implications for the money supply are concerned and this could lead to further financing controls being imposed. These on the whole would tend to increase the cost of funding local authority debt.

EVALUATING CONTROL POLICIES

The Lessons

Probably the most important lessons which can be learned from this experiment are:

(i) that revenue predictability is an important ingredient in any system of control;

(ii) that using the "gearing" effect of reducing grant aid is insufficient to contain expenditure absolutely, given the low level of electoral accountability of United Kingdom local authorities;

(iii) that to leave local authorities little time to plan their affairs is self-defeating for the central government;

(iv) whilst an element of rough justice is inevitable, a 'refined' rough justice which incorporates an attempt at sophistication, which produces leverage on individual authorities rather than on local government as a whole, provokes authorities to question the equity of the arrangement and may produce a counter-productive response;

(v) the complexity of two targets has confused financial planning and provided an excuse for authorities not to conform where it suited them;

(vi) changes in grant aid distribution from year to year actually make it more difficult for authorities to reduce expenditure because the gainers find it politically difficult to reduce expenditure when they are gaining grants, and the losers cannot reduce expenditure in practice as fast as they lose grants;

(vii) There is however some evidence that reductions in grant aid are causing authorities to reduce expenditure;

(viii) Since piecemeal controls tend to have unforeseen effects a comprehensive review should be undertaken whenever a change of stance on controls is required;

Table 6 above showed that authorities have reacted in different ways to the various targets they have been given. No clear picture has yet emerged apart from a general confirmation of paragraph (vii) above, namely that areas which have lost grants have tended to reduce expenditures. This is evidenced by the fact that the highest average cuts have been achieved in Inner London boroughs, which as a class of authorities has not done well from the new grant distribution.

But attempts to set GREs and targets for individual authorities have added to the dimension of dispute between local and central government by involving individual authorities. In the past this has been avoided by concentrating controls on total local authority spending. Individual targets may perhaps introduce an apparent element of 'fairness' -- which in practice is defined in political terms -- but in the long run may cause great damage to the credibility and hence stability of the system.

Consequences of Overspending

Local authorities undoubtedly have a major logistical problem in reducing expenditure as quickly as the central government would like. The example was given earlier of the problem of reducing the numbers of teachers employed. There are even more difficulties with closing schools as the child population falls because of the statutory procedures which have to be followed. Where local authorities can reduce expenditure quickly, many will do so -- for example by cutting back on maintenance, part-time staff, supplies and services, external contractors and agency services. This could have an unbalancing effect on the distribution of services and on the expenditure composition. It will also tend to result in the exporting of unemployment to the private sector. A beneficial effect though of a squeeze on resources will be to increase the search to improve efficiency. But greater value for money will not by itself produce the savings required.

The final response of the central government to the budgeted overspending by local authorities in 1981-82 was the imposition of a grant penalty. The central government obviously hoped that by imposing what is a severe penalty, local authorities would reduce revenue expenditure. But it is doubtful if local authorities will come entirely into line. First, there are the logistical difficulties of reducing expenditure which have been explained above. As time elapses the difficulties of meeting a target within a financial year grow. Secondly, since the budgets were prepared there has been an election and left wing groups have gained power in many of the larger local authorities, pledged to higher not lower, levels of local expenditure.

So a potential conflict is emerging and a second consequence in the short run may be a yet greater reduction in capital expenditure by local authorities, because of the central government's greater ability to control expenditure, to compensate for overspending on revenue account. This makes for a greater distortion than ever of the relationship between capital and revenue expenditure.

But the longer-term consequences are likely to be more serious, particularly if political polarisation grows. They could take several forms all of which are likely to reduce local authority discretion and some could effectively remove it altogether. The possibilities are:

(i) the taking by central government of powers to control rate levies or to control non-domestic levies only;

(ii) the taking of greater powers to reduce grant solely at the discretion of the Secretary of State coupled with the removal of the present power of local authorities to levy a supplementary rate. This has now occurred in Scotland and could be applied, albeit with more technical difficulty, in England and Wales;

(iii) the use of present powers to impose severe grant reductions upon local authorities to try to force them to bring down expenditure because of the consequential high burden upon ratepayers;

(iv) the removal of services from local government to give central government more direct control of them; advanced further education is the most likely immediate casualty;

(v) the removal of local rating powers completely.

The effect of further centralisation will be to create greater opportunities for confrontation over volumes of expenditure, and the same trend is likely to lead to confrontation over wage settlements to local government employees. Increasingly in the United Kingdom, local elections have been seen as a commentary on central government policies and the left wing gains in the recent elections imply dissatisfaction with those policies by the electorate. How far confrontation will be carried will therefore depend upon the national political mood.

However, it is worth noting, and this has not been thoroughly understood by local government, that the Parliamentary Opposition has not given any indication that it will repeal the critical parts of the Local Government Planning and Land Act of 1980, nor will it repeal the recent Scottish legislation. That implies therefore that both major politic parties are set on a course of centralisation, with more or less vigour. The driving force for both parties is the recognition that long-term electoral success depends upon producing policies which give a satisfactory economic performance for the United Kingdom. Neither party therefore wants to commit themselves to any changes which might weaken their power in this respect.

What Are the Alternatives?

The approaches set out in the previous section are all based upon continuing the trend to further centralisation. There are alternative routes which are the exact opposite of the centralisation approach now being developed. The alternatives are:

(i) Switch as many services as possible into the market place, leaving the market to set levels of investment, prices, distribution of services and type of service. This would leave local authorities to administer a rump of services of much less economic significance.

(ii) Promote accountability by securing much more strongly than at present the relationship between voting and paying for services. This would involve a reduction in central government grant aid, probably the abolition of non-domestic rating as a local government tax, and the introduction of a local income tax. This would obviously be a high risk route but it would certainly strengthen the concept of local democracy and might permit the devolution of more services to local government. Such a reform might have to be accompanied by both an organisational reform and electoral reform.

Of course route (i) would only be practical given a major change in political attitudes even though there are some services where the approach might be applied even now. The most important service where market forces could be harnessed is housing, which in the United Kingdom suffers from an inadequate pricing structure. Consequently subsidies and investment are distributed in a haphazard way. But a housing finance reform would need to extend across the whole sector and not be confined to public sector housing. Again, parts of the education service could be provided on a market basis -- specialised music education and school meals are examples.

From local government's point of view route (ii) is obviously the most attractive. It would make possible the detachment of local government from the central planning process. But whether or not that would ever be achieved would depend upon political and economic philosophy. A properly functioning democratic system could provide the brake on 'overspending' whether caused by high volume or inflation. Cash limit controls on grant aid could then be retained at the central government level, to give adequate management control.

Although local government would prefer route (ii), in practice local independence would not be painless. To make it work there would have to be stability and predictability in the system. This would mean simpler grant arrangements, perhaps limited to population and differences in the distribution of personal incomes. Special problems like rural sparsity and ethnic minorities would have to be supported by specific grants. If a local income tax were not available it would mean a major increase in domestic rate levies, but that would have a substantial effect upon accountability.

But any appearance of irresponsibility in spending by local authorities will strengthen the doubters against any radical reform. And as the analysis in this paper has shown, the trends which are beginning to appear, both in terms of expenditure and politically, could be construed by some commentators as growing evidence of irresponsibility.

However, there is a growing perception of the lack of local accountability and proposals are being considered of introducing a requirement that a local referendum should be held before a supplementary rate can be levied when a local authority needs to replace money lost by a withdrawal of grant aid. But the likelihood is that in many instances this would confirm the supplementary rate and hence the higher levels of expenditure. Confirmation is likely to occur because the pressure groups for the maintenance of public services would support the supplementary rate proposal, as would the local authority, and ratepayers are relatively unorganised, apart from the business ratepayers, who have no vote anyway. So the referendum approach could lead to spending above public expenditure targets.

CONCLUSION

Cash limits as applied to local government have only a limited impact on revenue expenditure although an increasingly important effect upon capital investment. On revenue expenditure cash limits are more in the form of an influence upon expenditure through restrictions on grant aid.

Until 1980-81 local authority expenditure conformed closely to central government spending targets, but that was in a period of a relatively stable level of revenue spending. As revenue spending begins to decline the likelihood of meeting targets seems to be lessening.

Local authority capital expenditure has fallen quite dramatically since the mid-1970s. One reason is because the central government has had more precise controls over capital expenditure which it has used to hold down capital investment to permit higher levels of revenue spending. -- In addition, the general financial constraints have probably caused local authorities to reduce new investment anyway.

The central government sees an economic upturn in the United Kingdom being achieved by a switch of resources to the private sector away from the public sector. It views this as the route to higher levels of national income. The political swing in the country appears to be against this. It does appear that the central government reaction will be to increase central control so that it can pursue its economic objectives. This will tend to increase confrontation but in the end the central government is likely to modify its attitudes -- regarding both levels of expenditure and the distribution of grant aid.

But the likelihood is that as things stand at present local government will not meet expenditure targets. As a consequence, grant aid will be reduced and rate levies will increase disproportionately. Both will produce political pressure on the central government to give it greater powers to control local authority activities. In the world of 'real politics' the Parliamentary Opposition will oppose the growth of centralisation but stop short of promising to repeal the legislation.

The real issue for the United Kingdom local government system however is not about cash limits and their effects as such, but about methods of restraining local spending decisions. Because the voting-paying relationship is so weak, cash limits along with other measures have been introduced to make added spending more difficult. So the issue of accountability is paramount, or to put it another way, the central government's policy should be designed to promote efficient behaviour by local authorities. But to achieve greater local accountability, more fundamental reforms are required, and to give the incentive to reform, confidence must be generated in the local government option.

The main risk for the central government in pursuing its present policies is that it may result in demands being made of individual local authorities which they are not prepared to meet. This could lead to a breakdown in services and administration, particularly if there are groups looking for political martyrdom. An essential ingredient of central government policy should be to avoid exactly this situation -- to find ways of making the local government system work without confrontation. Effective public administration requires that the militants as well as the moderates can work within the system because otherwise the former are in the end driven to take extra-constitutional actions.

Appendix ORGANISATION AND FUNCTIONS OF LOCAL GOVERNMENT

The local authorities in the United Kingdom are as follows:

London:	Greater London Council	1	
	London boroughs (including the City of London)	33	34
England and Wales (outside London):			
	metropolitan counties	6	
	metropolitan districts	36	
	non-metropolitan counties	47	
	non-metropolitan districts	333	
	Isles of Scilly	1	423
Scotland:	regions	9	
	districts	53	
	island areas	3	65
			522
Northern Ireland:	districts		
		26	26

The responsibilities of local authorities differ from country to country within the United Kingdom. There are even differences between the functions of the London local authorities and those operating elsewhere in England. Important differences in London concern the provision of the education and the police services. In London there are thirty-three London districts (including the City). Thirteen are classed as Inner London authorities and they are not responsible for the education service. This is provided by the Inner London Education Authority which is an independent authority, whose members are appointed by the Greater London

Council. The outer London authorities are education authorities. The police service is provided by the Metropolitan Police which is responsible directly to the Home Secretary. The Metropolitan Police is not a local authority although it raises about half its funds from the London local authorities through the Metropolitan Police precept.

An analysis of the distribution of services in England and Wales is set out in the table at the end of this Appendix. The analysis shows that many of the powers overlap between the two tiers of authority and there are many instances (for example, highway maintenance) of agency arrangements being made between them allowing one authority to act on behalf of another. Agreements may be reached setting out the different spheres of activity to avoid duplication of effort by districts and counties. Perhaps the most important difference in service provision in Scotland is that the Scottish regions are responsible for water and sewage disposal whereas in England and Wales that is the responsibility of regional water authorities, which are not local authorities.

A major difficulty with the present 2-tier system is that the distribution of functions, especially in the metropolitan areas, is such that the financial consequences of the plans of the different tiers of authority are not easy to reconcile. The most obvious example is the finance of transport undertakings in the metropolitan area where the county authority may provide substantial revenue support subsidies and either the total rate burden in the area has to increase or cuts have to be made in other services, mainly those provided by the district authorities. The opportunities to reconcile the competing resource demands of the transport service with, say, the education, housing and social services are very limited.

The local authorities which are responsible for levying and collecting the local tax, the rate (i.e. the rating authorities), are as follows:

England and Wales (including London)	- district council/ London boroughs
Scotland	- regional councils (but see below)
Northern Ireland	- provincial government

Those authorities which are not empowered to levy a rate can impose a precept upon the rating authority and the rating authority in levying its rate must take into account those precepts. A county precept (including the Greater London Council -- GLC -- precept) does not have to be uniform throughout the county area; and in London the Inner London Education Authority (ILEA) fixes its requirements and then the GLC collects an appropriate amount through the GLC precept from those boroughs where the education service is provided by the ILEA. There are other precepting Authorities in existence including parishes, joint boards (set up by two or more local authorities), regional water authorities and the Metropolitan Police. In Scotland the financing arrangements are different in that both regions and districts fix a rate levy. Technically one does not precept upon the other but the regional councils collect both the regional and district rates within their area.

At present a local authority has power to vary the local tax rate without any specific electoral approval which is unlike the situation which occurs for example in the United States. Government grants are payable to all local authorities including the main grant, the rate support grant (alternatively known as the block grant).

DISTRIBUTION OF FUNCTIONS BETWEEN LOCAL AUTHORITIES - UNITED KINGDOM

The following is a summary of the allocation of functions between the different types of local authority, which for authorities in England and Wales (outside London) is based upon Department of the Environment Circular 121/172. Some relatively minor changes have subsequently been made.

ENGLAND

County councils (outside metropolitan areas)
and metropolitan district councils.

Education
Youth employment
Personal social services
Libraries

All county Councils	All district Councils
Museums and art galleries (a)	Museums and art galleries (a)
Housing: Certain reserve powers	Housing: Provision Management Slum clearance House and area improvement
Town development (a)	Town development (a)
Planning: Structure plans Development plan schemes (b) Development control (d)	Planning: Local plans (c) Development control (d) Advertisement control

All county Councils	All district Councils
Derelict land (a)	Derelict land (a)
National parks	
Country parks (a)	Country parks (a)
Conservation areas (a)	Conservation areas (a)
Building preservation notices (a)	Building preservation notices (a)
	Listed building control
	Tree preservation (a)
	Acquisition and disposal of land for planning purposes, development or redevelopment including private development (a)
Footpaths and bridleways:	Footpaths and bridleways:
Surveys	
Creation, diversion and extinguishment orders (a)	Creation, diversion and extinguishment orders (a)
Maintenance (e)	
Protection (a)	Protection
Signposting	
Transportation:	Transportation:
Transport planning	
Highways (e)	
Traffic	
All parking	Off street parking (f)
Public transport (g)	Public transport undertakings (h)
Road safety	
Highway lighting	
Footway lighting (a)	Footway lighting (a)
Environmental health:	Environmental health:
Animal diseases	Food safety and hygiene
	Communicable disease
	Slaughterhouses
	Offices, shops and railway premises (j)
Refuse disposal	Refuse collection

All county Councils

Consumer protection (e.g. weights and measures, trade descriptions, explosives, food and drugs)
Police (k)
Fire (k)
Swimming baths (a)
Physical training and recreation (a)
Parks and open spaces (a)
Smallholdings

Airports (a)

All district Councils

Clean air
Building regulations
Coast protection
Cemeteries and crematoria
Markets and fairs
Byelaws
Swimming baths (a)
Physical training and recreation (a)
Parks and open spaces (a)
Allotments
Local licensing
Airports (a)

NOTES

(a) Concurrent powers exercisable by county and district councils and the exercise of powers by individual authorities may be governed by agreements operating within the county area.

(b) In consultation with district councils.

(c) Except in national parks where counties would be responsible. Responsibility for local plans is subject to development plan schemes or the structure plan.

(d) Primarily a district council function except in a national park or for certain defined 'county matters'.

(e) District councils may claim maintenance powers for footpaths, bridleways, and urban roads which are neither trunk roads nor classified roads.

(f) In accordance with the county transportation plan.

(g) Metropolitan counties are passenger transport authorities, non-metropolitan counties have co-ordination functions.

(h) Some non-metropolitan districts under local act powers.

(j) Fire precautions under the Offices, Shops and Railway Premises Act will be a county council responsibility.

(k) Subject to amalgamation schemes.

The main differences within London are:

(i) the police service is provided by the Metropolitan Police (apart from in the City of London which has its own police force) which is an appointed rather than an elected authority.

(ii) of the 33 London districts (including the City) 13 are classified as inner London authorities and they are not responsible for the education service; this is provided by the Inner London Education Authority (ILEA) which is an independent authority but whose members are appointed by the Greater London Council (GLC). The outer London authorities are education authorities.

(iii) the London districts are highway authorities in their own right for the maintenance and cleansing of roads other than trunk and classified roads.

(iv) the London districts are responsible for consumer protection and not the Greater London Council.

(v) the London districts are pension authorities operating their own pension funds and the GLC fund is confined to their employees and those of the ILEA only.

(vi) the GLC has certain housing powers and responsibility for the administration of some housing estates (although the latter will cease to be a GLC function).

Parish councils continue to exist after reorganisation and the system could be extended to the urban areas. The functions of parish councils are limited to a few activities but they have a right to be consulted about planning applications affecting land in their areas.

WALES

The 2-tier system of local government applies to Wales where the arrangements and distribution of functions broadly follow those applying in England outside the metropolitan areas. However, there are no parishes in Wales but 'communities'. Responsibility for the acquisition of development land is a function of a central Welsh organisation (the Land Authority for Wales) and whilst this organisation has close links with the local authorities in Wales, it lies outside the normal local government arrangements and its members are Government appointees.

SCOTLAND

The distribution of functions is broadly the same in Scotland as in the non-metropolitan county areas of England. The main exception is that water supply and sewage disposal are functions of the regional authorities, whereas in England and Wales they are functions of the regional water authority; and in the island areas the system of local government is single-tier.

NORTHERN IRELAND

The system of local government under the provincial government is single-tier, with the districts administering a limited range of environmental services.