LOCAL GOVERNMENT SPENDING AND CENTRAL CONTROL

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Since 1976 successive governments have sought to limit local government spending in Scotland, as in England and Wales. Their reasons for doing so are contentious and sometimes rather confused. Under the Labour Government, from 1976, priority was given to the industrial strategy and to the need to release resources for investment. From 1979, the accent has been on reducing total public spending, of which local government spending is a part, in order to control the Public Sector Borrowing Requirement. This latter approach is, however, problematic.

Apart from capital spending which is already tightly controlled by central government and has, as we shall see, fallen substantially, local government spending from its own resources does not contribute to the PSBR since local authorities are not allowed to borrow to cover revenue spending. Rate support grant is already controlled by central government and subject to cash limits. Ministers have also argued for reduced local government expenditure on the grounds that rates pose an intolerable burden on households and commercial businesses (industry is substantially derated in Scotland) though in fact most of the increase in domestic rates stems from reductions in central support. They have also advanced the argument that local expenditure is 'crowding out' private investment by pre-empting limited resources.

Finding a coherent strategy behind all this is consequently difficult but two considerations seem to impel the Scottish Office. First, there is the pressure of the Treasury, which regards local government expenditure for planning and control purposes as part of the Secretary of State's budget. So any overspend in relation to the totals spelt out in the Government's annual White Paper on Public Expenditure will count as a black mark for the Scottish Office. Secondly, there has been sporadic but forceful pressure from ratepayers' groups and Conservative interests, particularly in Edinburgh, for the Government to intervene to curb rates increases. So what are the controls open to the Secretary of State and what are their effects?

CONTROLS ON LOCAL EXPENDITURE

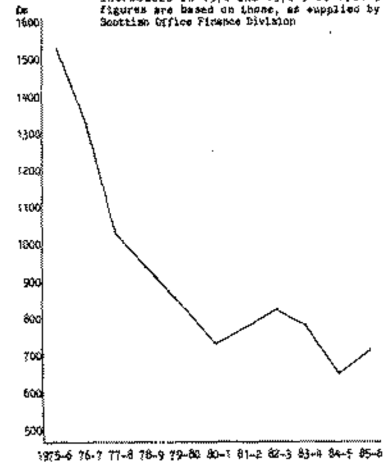
Capital expenditure is subject to control by central government in the form of 'capital allocations' for each of the major services. These constitute permission to spend on capital account up to the amount allocated, the money being found mainly from borrowing. In addition, local authorities are able to spend on capital projects a proportion of their 'capital receipts' from the sale of assets such as council houses.

Revenue spending is financed from rates, Rate Support Grant, some other specific grants, and charges such as rents and fares. Housing finance is rather different. Councils meet their revenue expenses for council housing from rents, Housing Support Grant and a contribution from the rates. In recent years, central government has cut back Housing Support Grant and, to try and ensure that the resulting burden falls on rents rather than rates, introduced a system whereby, if councils fail to put their rents up to raise the required amount, they will lose capital allocations on a pound for pound basis. So, by linking capital to revenue, central government ensures that total spending on council housing remains within set limits.

From the mid-1970s, successive governments have used their powers over capital allocations to reduce local authorities' capital spending. Figure 1, based on capital allocations, shows the marked cuts in capital expenditure since reorganisation, the largest single cut coming in 1977-78. The largest reductions have been in education and housing, while roads spending has largely been maintained. The rise in 1981-82 and 1982-83 is accounted for by the expansion of grants for private housing repairs.

Figure 1 Estimated capital expenditure, Scottish local authorities, 1975-76 to 1984-85 at 1982-83 prices (GDP deflator)

1975-6 to 1977-8 figures are estimates of capital spending from CIPFA, Rating Review. The present system of capital allocations was introduced in 1978 and 1978-9 to 1984-5 figures are based on these, as supplied by Scottish Office Finance Division



In 1979, George Younger inherited a number of means of inducing councils to reduce their current expenditure. These allowed him:

- to reduce the amount of spending allowed for in the Rate Support Grant settlement;

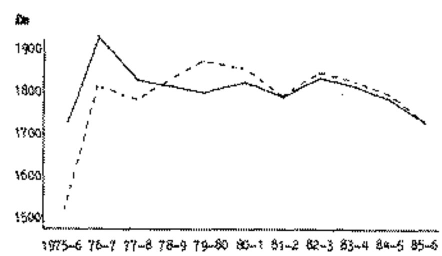
- to reduce the proportion of spending financed by grant, which under successive Secretaries of State has gone down from 75% in 1976-77 to 56.4% for 1985-86;

- to use the abatement procedure popularly known as 'clawback' whereby, until this year, the RSG was reduced across the board where expenditure out-turns for Scotland as a whole were considered excessive.

In addition, advisory guidelines on revenue spending were issued to each council, though these had no legal force.

Rate Support Grant for Scotland has since reorganisation been progressively reduced in real terms (see Figure 2). Two deflators, the GDP deflator and the index of local authority pay and prices have been employed to illustrate the way in which, in the late 1970s and early 1980s, the value of central support in terms of service provision was influenced by fluctuations in relative price and wage levels. Until 1979-80, the Rate Support Grant settlement more than covered pay increases which were controlled by the Callaghan Government's incomes policy. In the next two years, however, the purchasing power of the grant was rapidly eroded by "catching-up" pay settlements, including the Clegg comparability awards. At the same time, Housing Support Grant has fallen in five years from £200m to £52m in cash terms and now only 26 of the 56 housing authorities receive it.

Figure 2 Rate support grant, Scotland, 1975-1985 at 1982-1983 prices

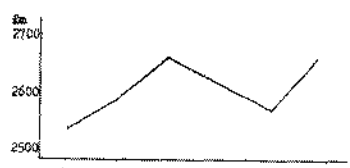


Deflated by: ———— GDP delfator

- - - - Local Authority Pay and Price Index

Source: COSLA

Figure 3 Current expenditure out-turns, Scottish Local Authorities, 1978-1979 to 1983-1984, at November 1982 prices



Source: Hansard, 27 July 1984, Cols 857-8. Adjusted by local authorities pay and price index.

By 1981, the Government was declaring that

Scottish local government revenue spending was out of control. In fact, since 1978 overall growth has been just 2.6% (see Figure 3). In contrast, domestic rates have shown sharp increases in real terms except in 1983-84 and 1984-85 (see Table 1).

Table 1 Average domestic rate increase in real terms

1980-1	13.0%
1981-2	26.0%
1982-3	6.8%
1983-4	-4.5%
1984-5	1.0%
1985-6	16.0%

Nevertheless, Mr Younger proceeded to add a series of selective powers to his existing general ones. The first stage was the Local Government (Miscellaneous Provisions) (Scotland) Act of 1981, allowing the Secretary of State to withdraw Rate Support Grant selectively from councils planning 'excessive and unreasonable' expenditure. The criteria for action were so widely defined as to give him virtually unfettered discretion. These powers were first used against seven councils in 1981. The following year, the law was changed again, in the Local Government and Planning (Scotland) Act, to give the Secretary of State power to force councils to make refunds to ratepayers and to strike a lower rate. In 1983, four councils were forced to cut their rates and in 1984, further statutory powers were taken, in the Rating and Valuation (Scotland) Act, allowing the Secretary of State to make the abatement of Rate Support Grant proportional to each council's spending over its guideline figure.

While some local councillors and officials concede that this type of selective abatement may be fairer than the 'across the board' clawback of the past in which low-spending councils suffered along with the rest, others have criticised the use of guidelines for this purpose. Guidelines were originally introduced at the request of local authorities themselves as just that - an indication of what councils should be spending. They have since been turned progressively into an instrument of control. While the methodology of calculating them has been refined over the years, they are still far short of the scientific rigour which might be expected of a control mechanism, even assuming that the 'correct' level of spending for a particular locality could be a matter of scientific calculation as opposed to political choice.

The latest Act also contains a reserve power allowing the Secretary of State in future years to invoke a rate-capping procedure similar to that now being applied in England. A further provision relates to housing, allowing the Secretary of State to issue ceilings for the Rate Fund Contributions of each district to the Housing Revenue Account so that larger subsidies would not merely attract capital penalties. They would be illegal.

Hitherto, the main legislative changes have given the Secretary of State wide discretion in choosing which councils to penalise and there is little doubt that political considerations have played a large part. Now, however, the automatic link between expenditure in relation to guidelines and abatement gives the Secretary of State less scope for discretion, should he choose to use this new weapon.

Last year, Mr Younger made it be known that there would not be a 'hit list' of councils for selective action this time. Soon, however, it became apparent that, under Treasury pressure, he was going to exact a general clawback because of the overall excess over guidelines of £115m. In the event, the clawback was £90 million, though the figure can be reduced if councils out-turn spending at the end of the financial year is less than their budgets. No less than 50 of the 65 Scottish local authorities were affected, with Strathclyde (£38.5 million) and Lothian (£12.5 million) accounting for over half the total.

Councils now had a choice. They could make cuts and hope to retrieve the lost grant; or they could go into deficit and fund that deficit with a rate increase. Mr Younger, however, has made it clear that, should councils take the latter course, he will not hesitate to invoke selective action under the 1981 and 1982 Acts or, in future years, his new rate-capping powers.

The result was a rare display of unity of purpose among Scottish local authorities. Lothian's Conservative administration were outraged, feeling that the Government had let them down after they had delivered spending cuts regularly since their election in 1982. In Edinburgh, the offending budget had actually been drawn up by the defeated Conservative administration before the 1984 May elections though the new left-wing Labour administration has proceeded to add to it, to the tune of some £2 million, in line with manifesto commitments.

The run-up to the 1985-86 financial year saw fresh controversy as Scottish ratepayers faced steep increases. There are three factors causing the rises. First, there is the effect of revaluation, which takes place more regularly in Scotland than in England which has not had one since 1973. The revaluation reflects the decline in industrial rental values since 1978 and shifts the burden onto domestic ratepayers. To a lesser extent, commercial ratepayers also benefit. The immediate effect would have been a 16% increase in domestic rates but the Secretary of State initially softened the blow by increasing the 'domestic' element of Rate Support Grant (the subsidy to domestic ratepayers) from 1p to 5p in the pound and at the same time reducing the derating of industry from 50% to 40%. This still left a net advantage to industrialists but a smaller one than the revaluation alone would have produced. The increase in domestic relief was to be funded partly by a £19m increase in the RSG with the remaining £31m to come from the needs and resources element.

The second factor behind the rates increases is a change in eligibility for Rate Support Grant. The proportion of eligible expenditure to be met from RSG was reduced from 60.2% to 56.4% and, simultaneously, the distribution of RSG was shifted in favour of the regions and against the districts. Some districts have lost half their Rate Support Grant in the course of a year, requiring large rate increases to make up the difference.

The third factor is the decision by some authorities to budget for increases in spending. Overall, councils have been budgeting to exceed the government's guidelines by some £90m, which will attract a clawback of Rate Support Grant at the end of the year, perhaps equivalent to the whole of the excess over guidelines. Attention focusses however, on Edinburgh District which has set out on a path of confrontation with the Government on spending in general and on its rate fund contribution to the Housing Revenue Account (the rate-borne subsidy to council housing) in particular. Under his new powers, the Secretary of State has set the rate fund contribution at £89.5m for Scotland as a whole, with ceilings of £26.6m for Glasgow, £6,015m for Aberdeen, £4.9m for Dundee and £2.8m for Edinburgh. Councils exceeding this would first have their capital allocations for council housing cut, pound for pound, and then be liable to legal proceedings in the Court of Session.

In consequence of all this, two quite separate battles have developed, one pitting the Secretary of State against his own supporters and the other pitting him against left-wing Labour authorities. Howls of protest went up from Conservative districts, many of which had cut their spending in accordance with the Governments' requests over the years, when the impact of revaluation and the RSG distribution became apparent. Demands grew for the revaluation to be cancelled, resolutions poured in for the Conservatives' Scottish Conference and the Chairman of the Scottish Conservative Party, amid great publicity went to protest to the Secretary of State. The campaign did have an effect. On 7 March Mr Younger announced a further concession to domestic ratepayers. The domestic relief is to be increased by a further 3p, to 8p in the pound, at a further cost of £38.5m. Most of the cost of this is to be found in the discretion which the Secretary of State has over the allocation of that expenditure within his own budget, though it is likely that Treasury approval will have been necessary. Cuts have consequently been made elsewhere in the Secretary of State's budget, on industrial, community health and environmental services. The remainder of the cost has been found by some creative accounting, notably from carrying forward expected capital underspending from this year and the proceeds of the £90m clawback on this year's Rate Support Grant - this element will certainly have required Treasury approval. It is unlikely that the concession will be enought to stem the rates revolt and demands that the Conservatives fulfil their pledge of a radical reform of the rating system continue to be heard from their own supporters.

Labour councils present the government with problems of a different order.

Selective action to reduce Rate Support Grant and set a lower rate is possible against Fife but unlikely in the case of the other regions. The first clash, though, will come over districts' rate fund contribution to their housing revenue accounts. Some time ago, the Labour Party in Scotland adopted the policy that council rents should go up by no more than £1 a week, irrespective of the Secretary of State's limits on subsidies. On the question of whether the party would thereby condone illegality, its leadership has adopted a carefully ambiguous line. Donald Dewar, the Shadow Secretary of State is certainly not a man to countenance law-breaking, but party policy seems to amount to just that. What has emerged seems to be a willingness to back councils making rate fund contributions in excess of the amount laid down in the parliamentary orders up until the point at which the courts rather than Scottish Office Ministers declare this to be illegal. As a device for gaining time, this has proved fairly effective. Of the twelve Labour councils which seemed set on a collision course for following party policy, only two, Stirling and Edinburgh, are on course to defy the law.

Aberdeen was the first district to indicate that it would set an illegal contribution, provoking an immediate response from the Scottish Office. A letter to the Council announced a reduction of capital expenditure consent until the council revised its budget proposals and threatened default action in the Court of Session. Faced with this, the council fell into line and raised its rents by £2.25, more than the original £1 set out in Labour policy but still less than the £2.91 envisaged by the Government. The balance is to be met by savings on maintenance.

In Glasgow, a complicated budget was produced which sailed so close to illegality as to produce a disclaimer from the Chief Executive and the Director of Finance. This, in fact, served as a political boost to the Labour group leadership, enabling them to impress their left wing and the activists of the influential Glasgow District Labour Party with their contempt for the new law and giving them time to negotiate a complicated package involving reclaiming grants from the Scottish Office. Rent increases are pegged to £1 a week in line with party policy, though another increase may be forced later in the year if negotiations on the reclaimed grants fail. Spending is just 3.8% above guidelines, probably enabling them to avoid selective action and rate capping.

Stirling have set a rate fund contribution £1.7m over the legal limit. They have a tradition of defying government wishes on spending but falling into line when legal sanctions loom and it is likely that this will happen again this year. The main battle is therefore likely to involve Edinburgh. Here a budget has been set which is 45% above the Scottish Office guideline, reflecting a real growth in spending of 44%. The rate fund contribution to the housing revenue account is £8.5m against the legal maximum of £2.8m. Rates are to increase by 79%.

The scenario here is quite clear. The Government will first take action to reduce Edinburgh's capital allocation for council housing by an amount equal to the excess rate fund contribution. Following an inquiry, it will then seek an order in the Court of Session for compliance on the part of the city with the rate fund contribution limit. Proceedings for surcharge and disqualification could then follow. At the same time, the Secretary of State is likely to make an order under the 1981 and 1982 Acts to reduce Edinburgh's Rate Support Grant and set a new lower rate.

It is not clear what Edinburgh's response will be. There is a feeling abroad in Labour left circles that Liverpool last year scored a notable victory against Patrick Jenkin and that all that is required is a firm stance, mobilising the party, the unions and tenants' groups, and the Government will give way. This is highly unlikely. The right and centre of the Labour Party in Scotland consider Edinburgh to be a very poor candidate for martyrdom and one which has brought many of its troubles on itself. The council could both have provided modest increases in service levels and kept rent increases down to below the Scottish average, while remaining within the law. Nor does the Scottish Secretary appear inclined to take an indulgent view of Edinburgh's spending. So it appears inevitable that the council will be forced to back down, giving a propaganda victory to the Secretary of State which many people on all sides in Scottish local government feel he does not deserve.