

PO-CH/NL/0251

PART F

Part . F.

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Begins : 17/5/88 .

Ends : 17/6/88 .



PO -CH /NL/0251



PART F

Chancellor's (Lawson) papers:

THE COMMUNITY CHARGE AND  
SETTLEMENT OF THE RATE  
SUPPORT GRANT SYSTEM

Disposal Directions : 25 years

27/9/95 .

NL/0251

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PO

PART F



DEPARTMENT OF HEALTH AND SOCIAL SECURITY

Richmond House, 79 Whitehall, London SW1A 2NS

Telephone 01-210 3000

From the Minister of State for Social Security and the Disabled

CHIEF SECRETARY	
REC.	18 MAY 1988
Mr Potter	
Mr Anderson, Mr Philip	
Mr Hand, Mr Melby	
Mr Tomball, Miss Austin	
Mr Saunders, Mr Rowden	
Mr Fellgett, Mr Call	

Rt Hon Nicholas Ridley MP  
 Secretary of State for the Environment  
 Department of the Environment  
 2 Marsham Street  
 LONDON SW1

17 May 1988

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Dear Nicky,

REBATING COLLECTIVE COMMUNITY CHARGE CONTRIBUTIONS

As you know, we have proposed that residents in premises that are registered for the collective community charge should be eligible to claim rebate on their collective community charge contributions in the same way as people liable for the personal community charge. However for those in collective community charge premises, the rebate would have to pass from the local authority to the claimant, who would then have to give it to the landlord, who would then have to return it to the local authority in discharging his community charge liability.

We have been considering the arrangements for this triangular procedure with the local authority associations, and I am afraid that we cannot see how it can be made to work in any way that would render us safe from criticism. Local authorities would be required to adopt very complex administrative arrangements, and claimants would have to follow administrative procedures which many of them may be incapable of comprehending. The rebate procedures would need to be so complex that they would risk attracting ridicule. People who spend a short period away from the main residence where they pay their personal community charge may stay either in a collective community charge hostel or in a hotel; we are already open to criticism in that we require poorer people to pay the community charge twice, and I would be reluctant to add to this by requiring them to be subject to complex rebating procedures also.

Officials here have discussed a range of possible approaches with the local authority associations, with representatives of our local office network, and with some of the proprietors of premises that are likely to attract collective community charge registration. The best option that we have been able to devise would require a typical unemployed claimant who booked into collective community charge accommodation to visit three offices in the course of a day: the UBO to register as unemployed; the DHSS office to claim income support; and the local authority to claim rebate and be issued with a voucher. Many claimants would be unable to manage this, and then would either have to pay the initial contribution in full without

having the resources to do so, or else the landlord would have to credit the claimant with a rebate and run the risk of having to bear the cost of it himself. Gearing themselves up to make emergency assessments would be difficult and expensive for both local offices and local authorities, and in some cases there will inevitably be delays while entitlement to income support is established. The new Social Fund arrangements make it unlikely that this particular group of claimants will be able to receive emergency loans. The use of vouchers instead of cash would reduce the risk of squandering or theft, but would not simplify the procedures.

These formidable difficulties could be overcome if local authorities were to be given the option of making maximum community charge benefit entitlement automatic for all the residents of particular collective community charge premises. Whether or not particular premises are to be registered for the collective community charge is, of course, to be a decision for the Community Charge Registration Officer, having regard to the conditions laid down in the legislation. Although we expect that a large majority of these premises will cater almost exclusively for transient people on low incomes, none of the conditions refer specifically to poverty. It is therefore difficult to see how the CCRO could reasonably decide whether the residents of a particular premises were likely to be eligible for benefit. Because of this, I propose that local authorities should be given the option of deciding whether or not premises should attract an automatic maximum rebate. Where it is decided that the automatic rebate should not apply, individual residents would remain eligible to apply for rebate. Where it is decided that the automatic rebate should apply, all residents would receive the maximum rebate without being required to claim it. They would pay the landlord only the 20% minimum collective community charge contribution, and the landlord would pay the local authority only 20% of his collective community charge liability. The principle of accountability would thus be maintained.

I see many advantages in this approach. It is likely that a clear majority of the residents of the premises where automatic maximum rebate applied would be entitled to maximum rebate anyway, so there would be little financial loss and a significant reduction in the administrative burden for local authorities, for landlords and for individual claimants, with a consequent reduction in administrative costs. And we would be much less vulnerable to political pressure. I must emphasise that I am proposing an automatic maximum rebate rather than an exemption from 80% of liability along the lines of the exemption for full-time students; this would significantly reduce the risk of other groups pressing for similar treatment, and would ensure that local authority revenue from the community charge was maintained.

If this proposal is acceptable in principle, we shall, of course, need to think through the implications very carefully. It will be important to ensure that local authorities do not have an incentive to grant automatic rebates in all cases, and we may need to deal with this through the arrangements for subsidising the costs of automatic rebates. You would need to consider the basis on which the landlord's handling fee is to be calculated, and I am advised that an amendment would be needed to Schedule 13 of the Local Government Finance Bill to provide us with the necessary power to alter the benefit entitlement provisions.

E.R.

I am copying this letter to Malcolm Rifkind and to Peter Walker since I envisage the proposed procedure applying in Scotland and Wales as well as in England, and also to John Major.

I would appreciate an early response, since Scottish local authorities are pressing us for full details of the rebate arrangements.

*Yours truly,*

*Nick,*

NICHOLAS SCOTT

CONFIDENTIAL

mp -

CHIEF SECRETARY

FROM: B H POTTER

Date: 18 May 1988

cc: PS/Chancellor Mr Phillips  
Mr Anson  
Mr Turnbull  
Mr Fellgett

## RSG SETTLEMENT 1989-90

We have just received a draft of the DOE paper for the first E(LA) discussion. It has been seen and approved by Mr Ridley as a basis for discussion with Treasury officials.

2. We have not yet had an opportunity to consider the figures carefully. But both the content and presentation of the paper are very much as anticipated in Mr Fellgett's minutes of 7 April and 5 May and my minute of 11 May. Mr Ridley's favoured option - option (ii) in the paper - would start from local authorities' budgets in 1988-89 and uplift these broadly in line with inflation plus a small amount for Community Charge preparation costs to set provision for 1989-90. By applying the same grant percentage as last year (adjusted for the transfer of the polytechnics) he would then propose an increase in AEG of about £1 billion. Mr Ridley also proposes that there should be a considerable reduction in the number of rate capped authorities from 17 this year to only 7 in 1989-90.

3. Mr Fellgett and I are meeting DOE officials on Friday to go over the draft paper. We will wish to examine closely the basis of the figures as well as challenging some of the more dubious assertions about local authorities behavioural response to grant levels eg the third sentence of paragraph 4. And we can of course feed in further thoughts if you wish us to do so.

4. While it should be helpful to have this indication of Mr Ridley's thinking in advance of the discussion with the Chancellor, this paper should not be regarded as pre-empting the scope of your bilateral discussions with Mr Ridley next Tuesday. Because E(LA) is not likely to meet until mid June, the paper need not be circulated for some time yet; and it could therefore take a rather different form, if following the bilateral discussion with Mr Ridley, an alternative approach seemed desirable.

Barry H. Potter

BARRY H POTTER



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LONDON SW1P 3AG

17 May 1988

*Dear Barry,*

**RSG SETTLEMENT 1989/90**

I attach an early draft we have prepared of a paper that our Secretary of State might put to E(LA) in due course.<sup>x</sup> On the main settlement proposals it does reflect discussions we have had with Ministers, but the thoughts on rate limitation have not yet been discussed with Ministers and should at this stage be treated as those of officials only.

I am asking my secretary to arrange a meeting with you later in the week when we can take any points you may have. I think it is then intended that the Secretary of State and the Chief Secretary should have a discussion, probably next week.

*Yours ever*  
*Chris*

**C J S BREARLEY**

*x There are also some supporting notes, to explain various technical points.*



## 1989/90 RATE SUPPORT GRANT SETTLEMENT

1. This paper sets out my proposals for the 1989/90 RSG settlement in the light of local authorities' budgets for this year. These proposals concentrate on those elements of the settlement which I announce in July ie provision for current expenditure, aggregate Exchequer grant (AEG), whether there is to be an unallocated margin, and major changes to grant mechanisms, if any. 1989/90 is the last year of the present RSG system and in considering these proposals it will be important to bear in mind the implications for the transition to the community charge. I also make proposals for rate limitation which will form part of the July announcement.

## OUTCOME OF THE 1988/89 SETTLEMENT

2. This year's settlement made provision for non-rate limited authorities to increase their 1987/88 budgeted current expenditure broadly in line with forecast inflation and for rate limited authorities to spend at their ELs. At the time of the Autumn Statement the GDP deflator was revised upwards to 4.5%. Settlement provision therefore represented a real terms cut of 0.5% for most authorities. The grant percentage at settlement was held constant and the grant total was increased by £750m to £13.775bn.

3. Preliminary indications are that in their budgets local authorities have chosen to increase current expenditure in real terms by about 3% to £28.6bn. This represents an overspend of about £1035m (3 %) on this year's settlement and as a consequence there is likely to be a block grant underclaim around £520m. The outcome of the 1988/89 RSG settlement and the pattern of local authority expenditure in recent years are set out in Appendix A.

4. This increase in expenditure is disappointing but not surprising: it is significantly less than in 1986/87 and 1987/88 - a result of our successful ratecapping policy. Both Conservative and non-ratecapped Labour authorities have budgeted to increase their total expenditure by about 8%. It is clear that local authorities, whatever the political control, have a preference for maintaining or increasing real spending rather than seeking to hold down the

rates. In making their budgets local authorities take account of the likely increase in their own costs, which are increasing more quickly than inflation, largely because of pay. Their 1988/89 budgets show they plan to increase services by about 1%, after allowing for pay and price increases - less than in the previous two years when the increase was over 2% pa.

5. The RSG settlement is an important influence on local authority spending but it does not provide a means through which it can be controlled. From 1990/91 the community charge will put additional pressure on spending through increased local accountability; this is of course a major reason for introducing the new system. But in the interim we need to recognise that there is no real scope for putting further pressure on local authority spending within the confines of the present RSG system.

#### OBJECTIVES FOR 1989/90

6. 1989/90 will be the last year of the present RSG system and in making decisions about the settlement we will need to bear in mind the implications for the community charge in 1990/91. In particular the pattern of community charges implied by the outcome of the 1989/90 settlement will be substantially carried forward into 1990/91 through the operation of the transitional safety net. I believe our objectives should be to maintain pressure on spending and to provide local authorities with as much stability as possible, recognising the limitations placed upon us in respect of both these objectives by the present system. This points towards a settlement broadly on the same lines as for this year, with a level of provision based on increasing local authorities' budgets by about the rate of inflation, a constant grant percentage (after taking account of the polytechnics) and no major changes to grant mechanisms.

7. Such a settlement would imply a shadow community charge for spending at need which would be broadly constant in real terms and thereby provide an orderly transition to the new system. In presenting the new system we have attached considerable importance to our argument that the Government will provide, through revenue support grant, specific grants and community charge rebates, about 50% of authorities' spending needs. The 1989/90 settlement will need also to keep us on track to fulfil this objective in 1990/91.

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8. I suggest that, as last year, we should consider distributional aspects of the settlement in the Autumn ie service control totals, grant-related expenditure methodology, and grant gains and losses. Again our objective here should be to provide as much stability as possible in grant distribution.

#### PROVISION FOR CURRENT EXPENDITURE

9. The Public Expenditure White Paper provides for local authority current expenditure in 1989/90 of £28.5bn. This figure was based on local authorities' 1987/88 budgets rolled forward by inflation in 1988/89 and 1989/90. The GDP deflator in each of these years has now been revised upwards by  $\frac{1}{2}\%$ . The White Paper therefore represented a real terms cut in provision of 1%. This year authorities are planning to spend £28.6bn and the White Paper provision no longer provides a credible starting point for 1989/90 because it implies a cash reduction in expenditure which authorities will not achieve.

10. Local authorities continue to spend more than they need. The Government's views on this can best be signalled by setting their need to spend at a lower level than provision ie through an unallocated margin. For legal reasons, in setting the level of provision we need to have regard to what authorities are in practice likely to spend even if we consider it too high. We also need to bear in mind that the Government will have a significant influence on a number of items of local authority expenditure in 1989/90. Teachers' pay will, as this year, be referred to the Interim Advisory Committee and expenditure provision for the IAC remit will need to be found from within the aggregate provision we agree for the settlement. Police pay is linked to average earnings and will therefore increase by more than inflation. The settlement will also need to make provision for the cost of preparing for the community charge: the provision options outlined below make an allowance of £100m for this expenditure. In my view it would simply not be credible if we were to set provision below a level which would enable authorities to increase their current expenditure by about the rate of inflation.

#### AGGREGATE EXCHEQUER GRANT

11. In each of the last two settlements we have maintained the grant percentage. This has been important both in presentational terms and in providing authorities with stability in their grant entitlement. Experience shows that cutting the grant percentage does not lead authorities to reduce

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expenditure - but gives them an excuse to spend up and successfully blame the consequential rate rises on Government. It also has an adverse effect on grant distribution. High resource areas, especially in the South East, bear the brunt of any reduction in the grant percentage because of the effect this has on resource equalisation. In addition reducing the grant percentage would run counter to our objective of providing government support for 50% of local spending needs in the new system. I therefore propose that we maintain the percentage of expenditure met by AEG, after adjusting for the polytechnics.

12. We have agreed that in 1989/90 both AEG and provision should be reduced by the same amount to take account of the removal of polytechnics from local authority control. As a result, the grant percentage is reduced from 46.2%, as at the 1988/89 settlement, to 44.7%. There is likely to be strong criticism of this treatment which enables the Exchequer to recover grant equivalent to the full cost of the polytechnics, rather than that proportion of expenditure which was supported by central Government grant. This would make it particularly difficult to reduce the grant percentage further.

#### UNALLOCATED MARGIN

13. In this year's settlement we increased the total of grant-related expenditure assessments (GRES) broadly in line with the (then) rate of inflation, with a number of exceptions notably for the police service where the GRE was increased in line with provision. There was therefore a margin between need to spend and provision on services of about £1.1bn; this indicated to authorities that in our view their need to spend was less than their likely expenditure. For next year we will wish to provide a similar signal.

14. However, if we were to increase GRES by the GDP deflator we would be signalling to authorities that they needed to spend about £2bn less than provision which itself could be less than than they are likely to spend. It would mean that very few authorities would be spending at or below GRE, casting doubt on our view that authorities need to spend at the level of their GRE. Authorities would argue, with some justification, that it was impossible for them to reduce expenditure by over 7% in one year.

15. We would also face considerable difficulties in substantiating a need to spend which was £2bn less than provision. The Audit Commission have identified potential value improvements of about £400m and some further savings should begin to flow from the introduction of competition into local authority services: most of these savings would however accrue in later years. Together these sources of savings might just support a margin of about £1bn but certainly not £2bn. I propose therefore an unallocated margin of about £1.2 billion ie the same percentage of current expenditure as this year.

#### OPTIONS

##### Provision

16. Against this background I have considered the following three options which are shown in Appendix B: these follow the same broad approach as for 1988/89. Option 1 assumes that non-rate limited authorities increase their current expenditure by 1% above the GDP deflator; under Option 2 by the GDP deflator (4%); and Option 3 by 1% less. In all options ratecapped authorities are assumed to spend at their EL - further details are given in paras 26 to 28 and Appendix D - and an additional allowance has been made for community charge preparation costs.

##### Spending assumptions

17. Appendix B shows the likely rate increases on two separate spending assumptions. The first assumes that authorities spend in line with settlement provision and the second assumes, as we did last year, that they spend at 3% above inflation, ie in line with recent experience. I think we would be misleading ourselves if we were to assume that authorities would spend at a lower level. In addition the Appendix shows the shadow community charge figures for spending at need (CCSN) and under each of the two spending assumptions.

##### Specific and supplementary grants

18. Each of the options assumes an increase in the total of specific grants of about £240m; this is the normal increase in recent years except where additional bids have already been agreed. No allowance has been made for new or substantially increased bids.

## Special funds

19. Each option also assumes that authorities will draw down special funds to the same extent as they have budgeted to do this year - by £567m; this in line with practice in recent settlements. There is some possibility that authorities will make greater withdrawals thus reducing the block grant underclaim. Special funds are not evenly distributed between authorities - some have none. Assuming a greater draw down would reduce our assumption about individual authorities "total expenditure" for any given level of expenditure provision. We would be criticised generally for setting an unrealistic spending assumption and authorities without special funds would face great difficulty in achieving expenditure in line with the settlement. I propose therefore that we assume the same drawings from special funds as in authorities' budgets for 1988/89.

## Grant

20. Appendix B exemplifies the three options for provision, described in para 16 above, and shows the effect on rate increases and implied community charges of maintaining the grant percentage, after adjusting for the polytechnics, at 44.7%.

## Discussion

21. Under Option 1 provision rate increases for non-ratecapped authorities would be on average 4.8% on the higher spending assumption. It would mean an increase in provision of about £1.6bn and grant of £1.2bn. I believe this would provide too generous a settlement for local authorities: it would give authorities the wrong signal about our views on their expenditure and I do not therefore recommend it.

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using 22. Option 3 provision would mean average rate increases for non-ratecapped authorities of 7½% at the higher spending assumption, well above inflation.

23. My preference is for Option 2 which would set provision such that non-rate limited authorities could increase their current expenditure in line with their 1988/89 budgets increased by the GDP deflator. I believe that a lower level of provision would not take proper account of expenditure which is subject to Government influence. With a constant grant percentage, average rate increases for the non-ratecapped authorities would be 6% - ie still above

the rate of inflation on the higher spending assumption. As usual there would of course be significant variations around these averages. 2 shire counties and 190 shire districts would have rate increases above 10%. A number of authorities would go out of grant, in addition to Hertfordshire and Surrey which are already out of grant: a number of other high resource authorities particularly in the South East would lose grant.

24. Option 2 would meet our objectives on the community charge. It would provide a smooth transition to 1990/91 with a community charge for spending at need of £212 which represents about a real terms standstill on this year's equivalent figure of £202. In terms of the distribution of community charges it would mean that a reasonable proportion of authorities would have charges below the figure for spending at assessed need. It would also keep us on course for presenting the new system as one in which central Government would maintain its contribution to local needs at 50%.

25. Option 2 would not be cheap: it would mean an increase in provision of about £1.3bn above that provided for in the White Paper, adjusted for polytechnics, but such provision must either be made explicitly in our spending plans or in the Reserve. On grant it would mean an increase in AEG of about £1bn, to £14bn, about £240m of this would be taken up by the increase in specific grants: in practice the increase would be abated because of grant underclaim - about £380m on the higher spending assumption.

#### RATECAPPING

26. I have considered the expenditure position and legal and practical constraints on the selection of authorities for rate limitation. A fuller analysis is at Appendix D. I propose to adopt for the last year of the present system the same selection criteria for general purpose authorities as I used last year. This would mean that seven authorities, all previously selected, would be selected for rate limitation in 1989/90 as compared with seventeen authorities last year. I have been advised by Counsel that to adopt any stricter criteria would entail considerable risk of successful legal challenge. And the reduced number of authorities in the field for selection this year is itself a measure of the success of our ratecapping policy.

27. I am also proposing to set - using general principles as required - expenditure levels for selected authorities equal to a cash stand still on their 1989/90 expenditure levels. This continues the policy I have followed in the past. I believe that such levels will be tough, but reasonable given the excessive level of these authorities' spending. And under the ratecapping procedures it is open to authorities to apply to me for an increase in their levels if they consider this would be appropriate given their particular circumstances.

28. This year the new authorities (ILEA and the joint police, fire and civil defence, and passenger transport authorities established on abolition of the GLC and metropolitan county councils) will no longer be automatically selected for ratecapping. Colleagues responsible for the services provided by these authorities are bringing forward their own proposals for ratecapping in relation to these authorities. It is, however, important that both in terms of presentation and of minimising the risk of successful legal challenge that we avoid inconsistencies between the capping proposals adopted for the various joint authorities and the general purpose authorities.

#### CONCLUSION

29. I recommend to colleagues that for 1989/90:

- i. we should make no major changes to grant mechanisms;
- ii. we should provide for local authority current expenditure of £29,090 million which will allow non-ratecapped authorities to increase their current expenditure budgets in line with inflation;
- iii. we should maintain the grant percentage at 44.7%, after adjusting for polytechnics, and provide AEG of £14,026 million;
- iv. we should retain an unallocated margin of about £1.2bn;
- v. we should select 7 general purpose authorities for rate limitation on the same criteria as this year, ie budgeted expenditure of more than 12½% over GRE for previously selected authorities and for newly selected authorities 12½% over GRE and growth of 6% over 1988/89, and set ELs at the same level as this year.



This package will I believe achieve our objectives on maintaining pressure on spending, within the constraints imposed by the present system, it will provide stability in the distribution of grant and put us on the right track for achieving our objectives for community charges at the start of the new system in 1990/91.

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## LOCAL AUTHORITY EXPENDITURE AND GRANT (£ million)

	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89
Expenditure Provision	16180	18000	19692	20389	21314	22364	25711	27538
Outturn	17472	19051	20285	21600	22300	24171	26522	28573
Overspend	1292	1051	593	1211	986	1807	811	1035
% cash increase provision		11.2	9.4	3.5	4.5	4.9	15	7.1
% cash increase outturn		9	6.5	6.5	3.2	8.4	9.7	7.7
% real increase provision		3.9	4.5	-0.8	-1.5	1.6	9.5	2.5
% real increase outturn		1.8	1.7	2.0	-2.6	5.0	4.5	3.1
GDP deflator (%)		7.12	4.70	4.42	5.97	3.26	5.00	4.50
AEG (at Settlement)	10895	11484	11782	11872	11764	11815	13025	13775
% cash increase holdback/underclaim		5.4	2.6	0.8	-0.9	0.4	10.2	5.8
	123	232	281	261	50	0	266	521
Average increase in general rates (%)	19.8	12.9	6.4	5.5	7.3	11.3	5.8	7.6
Average increase for non-ratecapped authorities (%)					n/a	n/a	8.2	9.7

## OPTIONS FOR 1989/90 RATE SUPPORT GRANT SETTLEMENT

	Spending at Settlement Expenditure Assumption	Spending at 3% above Option 2 Settlement Expenditure Assumption
<b>OPTION 1</b>		
-----		
Current Provision £29,340m (1% above GDP deflator)		
AEG at Settlement:	44.7% £14,137m	44.7% £14,137m
AEG + rebates at Settlement:	49.4%	49.4%
Average rate increase:		
Non-rate Limited	.3%	4.8%
All authorities	-.6%	3.5%
Grant underclaim	-	£256m
Outturn AEG percentage	44.7%	43.2%
CC at need (CCSN)	£216	£216
CC at spending level	£233	£247
-----		
<b>OPTION 2</b>		
-----		
Current Provision £29,090m (in line with GDP deflator)		
AEG at Settlement:	44.7% £14,026m	44.7% £14,026m
AEG + rebates at Settlement:	49.5%	49.5%
Average rate increase:		
Non-rate Limited	-.7%	6.1%
All authorities	-1.3%	4.8%
Grant underclaim	-	£381m
Outturn AEG percentage	44.7%	42.5%
CC at need (CCSN)	£212	£212
CC at spending level	£229	£250
-----		
<b>OPTION 3</b>		
-----		
Current Provision £28,830m (1% below GDP deflator)		
AEG at Settlement:	44.7% £13,909m	44.7% £13,909m
AEG + rebates at Settlement:	49.5%	49.5%
Average rate increase:		
Non-rate Limited	-1.6%	7.5%
All authorities	-2.1%	6.1%
Grant underclaim	-	£514m
Outturn AEG percentage	44.7%	41.7%
CC at need (CCSN)	£209	£209
CC at spending level	£225	£253

OPTIONS FOR 1989/90 RATE SUPPORT GRANT SETTLEMENT

NOTES TO APPENDIX B

A. PROVISION: Option 1 is based on a 5% increase on 1988/89 budgeted current expenditure for non rate limited authorities plus current expenditure consistent with ELs for rate limited authorities and 1989/90 budget for Metropolitan Police. In options 2 and 3 the increase for non rate limited authorities is 4% and 3% respectively. In all cases £100m has been added for the set up cost of community charge collection.

B. EXPENDITURE ASSUMPTION: Column 1 of the table assumes that authorities spend at the relevant settlement expenditure assumption described below. Column 2 assumes for all options that non-rate limited authorities spend at 3% above the Option 2 Settlement expenditure assumption and rate limited authorities spend at EL. In all cases allowance has been made for the additional set up costs of community charge collection.

SETTLEMENT EXPENDITURE ASSUMPTION

	<u>OPTION 1</u>	<u>OPTION 2</u>	<u>OPTION 3</u>
Rate-Limited authorities	EL	EL	EL
Metropolitan Police	assumed 1989/90 budget	assumed 1989/90 budget	assumed 1989/90 budget
Non-Rate limited authorities	1988/89 budgets +5%	1988/89 budgets +4%	1988/89 budgets +3%
	+ community charge set up costs	+ community charge set up costs	+ community charge set up costs

C. RATES: At both spending levels, rate and precept limited authorities are assumed to levy a rate equal to their rate/precept limit.

Rate changes shown are for general rates: increases in domestic rates would be about 1% higher.

D. BLOCK GRANT MECHANISMS AND GRES: These are as in 1988/89 except that there is no cap on grant gains.

E. Implied Community Charge for spending at need is lower than community charge at settlement spending assumption because total GRE is lower than total provision.

## 1989/90 RATE SUPPORT GRANT SETTLEMENT: OPTION 1

Current provision £29,340m - 5% increase (1% above GDP deflator)

## ESTIMATED AVERAGE % CHANGES IN LOCAL RATES

	Spending at Settlement Expenditure Assumption	Spending at 3% above Option 2 Settlement Expenditure Assumption
	(1)	(2)
AEG at Settlement:	£14,137m	£14,137m
	(%)	(%)
TOTAL England	-0.6	3.5
TOTAL Shire districts	6	11
TOTAL Shire counties	0	5
TOTAL Metropolitan districts	1	6
TOTAL Joint Police Authorities	6	11
TOTAL Joint Fire Authorities	-2	3
TOTAL Joint Transport Authorities	3	5
TOTAL central boroughs	0	1
TOTAL other inner London boroughs	-22	-16
TOTAL inner London boroughs	-10	-7
ILEA (RL)	-2	-2
TOTAL outer London boroughs	-6	-0
Metropolitan Police	14	14
London Fire & CD Authority	-21	-16
TOTAL Shire areas	1	5
TOTAL Metropolitan areas	1	6
TOTAL London	-6	-3

## Notes

1. Columns 1 to 2 correspond to columns 1 to 2 of Appendix B
2. Rate changes shown are the average for all authorities in the class
3. Negative numbers indicate rate decreases

## 1989/90 RATE SUPPORT GRANT SETTLEMENT: OPTION 1

Current provision £29,340m - 5% increase (1% above GDP deflator)

## ESTIMATED AVERAGE % CHANGES IN LOCAL RATES

	Spending at Settlement Expenditure Assumption	Spending at 3% above Option 2 Settlement Expenditure Assumption
	(1)	(2)
AEG at Settlement:	£14,137m	£14,137m

## SUMMARY OF CHANGES BY NUMBERS FALLING INTO DIFFERENT BANDS

## SHIRE COUNTIES

Reduction	14	3
Increase less than 5%	23	14
Increase 5% to 10%	2	21
Increase 10% to 15%	-	1
Increase more than 15%	-	-

## SHIRE DISTRICTS

Reduction	58	31
Increase less than 5%	48	30
Increase 5% to 10%	75	59
Increase 10% to 15%	38	70
Increase more than 15%	78	107

## MET DISTRICTS

Reduction	14	5
Increase less than 5%	16	13
Increase 5% to 10%	2	12
Increase 10% to 15%	2	2
Increase more than 15%	2	4

## JOINT AUTHORITIES (MET AREAS)

Reduction	7	3
Increase less than 5%	6	6
Increase 5% to 10%	2	4
Increase 10% to 15%	1	2
Increase more than 15%	2	3

## INNER LONDON BOROUGHES

Reduction	10	8
Increase less than 5%	2	3
Increase 5% to 10%	-	-
Increase 10% to 15%	-	1
Increase more than 15%	1	1

## OUTER LONDON BOROUGHES

Reduction	17	8
Increase less than 5%	1	8
Increase 5% to 10%	2	2
Increase 10% to 15%	-	2
Increase more than 15%	-	-

Notes: Columns 1 to 2 correspond to columns 1 to 2 of Appendix B

## 1989/90 RATE SUPPORT GRANT SETTLEMENT: OPTION 2

Current provision £29,090m - 4% increase (in line with GDP deflator)

## ESTIMATED AVERAGE % CHANGES IN LOCAL RATES

	Spending at Settlement Expenditure Assumption	Spending at 3% above Option 2 Settlement Expenditure Assumption
	(1)	(2)
AEG at Settlement:	£14,026m	£14,026m
	(%)	(%)
TOTAL England	-1.3	4.8
TOTAL Shire districts	5	12
TOTAL Shire counties	-0	6
TOTAL Metropolitan districts	-0	7
TOTAL Joint Police Authorities	5	13
TOTAL Joint Fire Authorities	-3	5
TOTAL Joint Transport Authorities	3	7
TOTAL central boroughs	-0	1
TOTAL other inner London boroughs	-21	-12
TOTAL inner London boroughs	-10	-5
ILEA (RL)	-2	-2
TOTAL outer London boroughs	-7	2
Metropolitan Police	16	16
London Fire & CD Authority	-22	-15
TOTAL Shire areas	0	6
TOTAL Metropolitan areas	0	8
TOTAL London	-6	-1

## Notes

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- Columns 1 to 2 correspond to columns 1 to 2 of Appendix B
- Rate changes shown are the average for all authorities in the class
- Negative numbers indicate rate decreases



## 1989/90 RATE SUPPORT GRANT SETTLEMENT: OPTION 2

Current provision £29,090m - 4% increase (in line with GDP deflator)

## ESTIMATED AVERAGE % CHANGES IN LOCAL RATES

	Spending at Settlement Expenditure Assumption	Spending at 3% above Option 2 Settlement Expenditure Assumption
	(1)	(2)
AEG at Settlement:	£14,026m	£14,026m

## SUMMARY OF CHANGES BY NUMBERS FALLING INTO DIFFERENT BANDS

SHIRE COUNTIES		
Reduction	17	3
Increase less than 5%	22	10
Increase 5% to 10%	-	24
Increase 10% to 15%	-	2
Increase more than 15%	-	-
SHIRE DISTRICTS		
Reduction	61	25
Increase less than 5%	60	25
Increase 5% to 10%	67	57
Increase 10% to 15%	35	64
Increase more than 15%	74	126
MET DISTRICTS		
Reduction	22	4
Increase less than 5%	9	9
Increase 5% to 10%	2	13
Increase 10% to 15%	2	6
Increase more than 15%	1	4
JOINT AUTHORITIES (MET AREAS)		
Reduction	7	3
Increase less than 5%	7	4
Increase 5% to 10%	2	4
Increase 10% to 15%	1	4
Increase more than 15%	1	3
INNER LONDON BOROUGHES		
Reduction	10	7
Increase less than 5%	2	2
Increase 5% to 10%	-	1
Increase 10% to 15%	-	-
Increase more than 15%	1	3
OUTER LONDON BOROUGHES		
Reduction	18	6
Increase less than 5%	-	8
Increase 5% to 10%	2	4
Increase 10% to 15%	-	1
Increase more than 15%	-	1

Notes: Columns 1 to 2 correspond to columns 1 to 2 of Appendix B

## 1989/90 RATE SUPPORT GRANT SETTLEMENT: OPTION 3

Current provision £28,830m - 3% increase (1% below GDP deflator)

## ESTIMATED AVERAGE % CHANGES IN LOCAL RATES

	Spending at Settlement Expenditure Assumption	Spending at 3% above Option 2 Settlement Expenditure Assumption
	(1)	(2)
AEG at Settlement:	£13,909m	£13,909m
	(%)	(%)
TOTAL England	-2.1	6.1
TOTAL Shire districts	4	13
TOTAL Shire counties	-1	7
TOTAL Metropolitan districts	-1	9
TOTAL Joint Police Authorities	4	14
TOTAL Joint Fire Authorities	-4	6
TOTAL Joint Transport Authorities	3	8
TOTAL central boroughs	-1	1
TOTAL other inner London boroughs	-20	-8
TOTAL inner London boroughs	-10	-4
ILEA (RL)	-2	-2
TOTAL outer London boroughs	-8	4
Metropolitan Police	19	19
London Fire & CD Authority	-23	-13
TOTAL Shire areas	-1	8
TOTAL Metropolitan areas	-1	9
TOTAL London	-6	-0

## Notes

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1. Columns 1 to 2 correspond to columns 1 to 2 of Appendix B
2. Rate changes shown are the average for all authorities in the class
3. Negative numbers indicate rate decreases

## 1989/90 RATE SUPPORT GRANT SETTLEMENT: OPTION 3

Current provision £28,830m - 3% increase (1% below GDP deflator)

## ESTIMATED AVERAGE % CHANGES IN LOCAL RATES

	Spending at Settlement Expenditure Assumption	Spending at 3% above Option 2 Settlement Expenditure Assumption
	(1)	(2)
AEG at Settlement:	£13,909m	£13,909m

## SUMMARY OF CHANGES BY NUMBERS FALLING INTO DIFFERENT BANDS

## SHIRE COUNTIES

Reduction	22	2
Increase less than 5%	17	3
Increase 5% to 10%	-	26
Increase 10% to 15%	-	8
Increase more than 15%	-	-

## SHIRE DISTRICTS

Reduction	72	23
Increase less than 5%	68	20
Increase 5% to 10%	57	50
Increase 10% to 15%	30	60
Increase more than 15%	70	144

## MET DISTRICTS

Reduction	23	2
Increase less than 5%	8	5
Increase 5% to 10%	2	16
Increase 10% to 15%	2	8
Increase more than 15%	1	5

## JOINT AUTHORITIES (MET AREAS)

Reduction	8	2
Increase less than 5%	7	4
Increase 5% to 10%	1	3
Increase 10% to 15%	1	5
Increase more than 15%	1	4

## INNER LONDON BOROUGHS

Reduction	11	7
Increase less than 5%	1	2
Increase 5% to 10%	-	-
Increase 10% to 15%	-	1
Increase more than 15%	1	3

## OUTER LONDON BOROUGHS

Reduction	18	6
Increase less than 5%	-	2
Increase 5% to 10%	2	9
Increase 10% to 15%	-	1
Increase more than 15%	-	2

Notes: Columns 1 to 2 correspond to columns 1 to 2 of Appendix B

## SELECTIVE RATE LIMITATION 1989/90

1. My proposals for ratecapping, which must by law be determined by means of general principles, would involve the selection of 7 general purpose authorities. This is fewer than in previous years but to attempt to select even three or four more would be unacceptably risky. To do so we would have to tighten the selection criteria considerably and Counsel's opinion is that, given the difficulty we would then face in constructing a reasoned defence against challenge, this would seriously increase the danger of a defeat in the courts.
2. The fact that we aim to select only 7 general purpose local authorities for ratecapping this year is a vindication of the system - even allowing for the effects of creative accounting, the budgets of the authorities traditionally in the ratecapping field are now under much more restraint.
3. For previously selected authorities I therefore propose to maintain the selection criteria for the authorities selected in the current year (budgets of more than 12½% spending over GRE). I also propose to maintain the same criteria I used last year for authorities not previously selected - GRE +12½% linked with the growth criterion of an increase in spending over the previous year of 6%, - though in fact this means that no new authorities will be selected.
4. The effect of this selection is that 6 inner London boroughs and Thamesdown District would be re-selected (see Table A).
5. This year, the joint authorities (those for fire, police and transport and the Inner London Education Authority) have come out of automatic precept limitation. The arrangements for handling these authorities have been discussed with the colleagues concerned and we have agreed that each of us will deal throughout with those authorities for which he has the main service responsibility. Colleagues are therefore bringing forward separate proposals for their own authorities. It is important, both in terms of presentation and of minimising the risk of successful legal challenge that any differences between our proposals can be supported by sound, reasoned argument sustainable at law.
6. My proposals for expenditure levels (or ELs, the starting point for the eventual rate limits) are broadly similar to the approach used last July. All seven selected authorities would have their EL for 1989/90 frozen at the current year's cash level, which for 6 of the 7 means the same as the 1986/87 level. The resulting figures for individual authorities are shown in Table B. The current policy has been a success: the very highest spenders have been compelled to make cumulative cuts in total expenditure at the level of inflation or a little more. The result is that the excess in authorities' total expenditure over GRE has gradually fallen over the years of ratecapping. Continuing this cash freeze policy would thus maintain the pressure on the overspenders.
7. A complicating factor is that many of these authorities are still making use of creative accounting, enabling a true expenditure level to be maintained above their EL. There is, however, reduced scope for creative accounting than in the past and it is less of a feature of 1988/89 budgets; this trend may very well continue. Table B shows the implied cash reductions that authorities would be required to make with my proposed ELs; on true budgets, these are considerably tougher, averaging around 10%, than the implied reductions on the total expenditure figures. The reductions we are requiring will have varying effects on local authorities, depending on their individual circumstances. The proper time to have regard to these is at the redetermination stage when we can take a hard look at any representations authorities may wish to make.

TABLE A

## SELECTION OF AUTHORITIES FOR RATE LIMITATION 1989-90

	OVERSPEND ON GRE %	SPENDING GROWTH 1987-88 TO 1988-89
A. re-selected authorities		
THAMESDOWN	69.0	3.8
GREENWICH	39.6	1.6
DAMDEN	29.7	-8.0
LEWISHAM	29.2	-1.3
TOWER HAMLETS	23.1	2.5
HACKNEY	19.7	-10.2
SOUTH-WARK	13.1	-10.2
B. authorities not reselected		
DASILDON	62.8	-25.9
MIDDLESBROUGH	10.7	-1.7
KINGSTON-UPON-HULL	9.4	-16.0
NEWCASTLE-UPON-TYNE	9.2	1.7
LAMBETH	8.9	-0.1
MANCHESTER	8.5	0
LIVERPOOL	8.3	-1.7
WALTHAM FOREST	8.0	-7.0
HARINGEY	8.2	-0.1
EALING	7.8	1.1
C. authorities not selected but spending more than 12.5% over GRE		
CITY OF LONDON	97.3	2.7
BLACKBURN	25.2	-3.4
BRISTOL	23.3	2.7
LEICESTER	17.9	-18.2

TABLE B

## RECOMMENDED EXPENDITURE LEVELS 1989-90

	1988-89 TOTAL EXPENDITURE £m	1980-90 EXPENDITURE LEVEL £m	CHANGE FROM 1988-89 BUDGET %	FROM 1988-89 UNDERLYING EXPENDITURE
CAMDEN	139.463	136.924	-1.8	-14.5
GREENWICH	95.230	95.230	0.0	-13.7
HACKNEY	131.048	128.572	-1.9	-12.3
LEWISHAM	122.045	115.594	-5.3	-13.9
SOUTHWARK	132.723	134.193	1.1	-13.0
TOWER HAMLETS	126.033	124.033	-1.6	-6.7
THAMESDOWN	<u>15.422</u>	<u>14.201</u>	<u>-7.9</u>	<u>-7.9</u>
	761.964	748.747	-1.7	

## BACKGROUND ASSUMPTIONS FOR 1989/90 RSG SETTLEMENT

1. 1988/89 base position: In 1989/90 polytechnics will no longer be funded by local authorities but will instead be funded direct by central government through the PCFC. Ministers have agreed that to achieve neutrality between local and central taxpayers both relevant expenditure and AEG should be reduced by the amount to be transferred to the PCFC. The attached note explains the adjustments we have made to 1988/89 aggregate figures to remove polytechnics: this implies a reduction in relevant expenditure of £832m. To obtain an adjusted base position for 1988/89 we have reduced expenditure of individual authorities using the available information from DES is accordingly. Individual authority grant entitlements however are reduced by only £736m since ILEA, Hertfordshire and Surrey will receive no grant in 1988/89 and Oxfordshire will receive less grant in 1988/89 than the assumed reduction in education spending.

2. For comparative purposes 1988/89 grant entitlements have also been adjusted to correct for the Bromley and TVEI errors which will be corrected in the first Supplementary Report.

3. The implications for rates of the various options are based on 1988/89 actual rate poundages. We assume no use of balances in 1989/90.

4. Current expenditure: for the base case (provision Option 2) current expenditure provision has been set at 1988/89 adjusted budgets increased in line with the GDP deflator. To this we have added £100m for community charge collection set up costs. We assume the same service distribution of current provision as implied by 1988/89 budgets, apart from a 3% relative growth for the police service.

5. Relevant expenditure and total expenditure: these have been derived using best estimates for non-current expenditure, specific and supplementary grants and non-relevant expenditure. Contributions to special funds and RFRACs to HRA, 1988/89 budget figures have been used.
6. GREs: Total GRE has been set so that the unallocated margin on non-police current expenditure is the same % as in 1988/89.
7. AEG: the base case assumes the same percentage of relevant expenditure as at 1988/89 settlement adjusted for removal of polytechnics ie. 44.7%. To derive a figure for total central government support we have included an estimate for the central government contribution to rate rebates.
8. Grant distribution mechanisms: throughout we have used the same slopes, threshold and London resource discount as in 1988/89. Safety nets have also been calculated on the same basis as the 1988/89 settlement. And the London rate equalisation scheme has been uprated as in 1988/89.
9. Expenditure assumption: for the settlement spending assumption we assume the Metropolitan Police spend at budget - £536m compared with £498m in 1988/89; rate capped authorities spend at assumed expenditure levels; all other authorities have a uniform percentage uplift on 1988/89 adjusted for removal of polytechnics; and non rate capped rating authorities spend £100m extra on community charge set up costs, distributed in line with the extra allowed for as part of the rate collection GRE. The higher expenditure assumption assumes a 3% overspend on settlement assumption.
10. LRT levy: the assumed LRT levy for 1989/90 is 5p compared with 6.07p in 1988/89.



## 1989/90 RSG SETTLEMENT: ADJUSTMENTS TO 1988/89 FIGURES FOR POLYTECHNICS ETC

The attached table includes unadjusted and adjusted figures for 1988/89 settlement and budgets. The adjustments relate to the removal of polytechnics from the LA sector and the inclusion within AEG of Imperial and National Service (INS) grant and Careers Service Strengthening Scheme grant. Adjustments are needed

- \* to settlement figures to calculate an adjusted AEG percentage for 1988/89
- \* to budget figures to provide an adjusted 1989/90 expenditure base for rolling forward

### Polytechnics

-----

The adjustments for polytechnics differ between settlement and budget. They are:

	Adjustment to settlement (£m)	Adjustment to budgets (£m)
	-----	-----
Current expenditure	-735	-740
Loan charges	-97	-98
	-----	-----
Relevant and total expenditure	-832	-838
Grant-related expenditure (GRE)	-832	-832
AEG, RSG and block grant	-832	-832

These adjustments are based on the information in Miss Treen's letter of 12 April to Mr Bolt. The budget adjustment include a slight upward revision to the pools figure allowed for in the settlement.

### INS grant

-----

We have assumed that INS grant is abolished and the rate of police specific grant for the Metropolitan Police correspondingly increased from 51% to 52%. Current and relevant expenditure have both been assumed to rise by £20m, as has the total of specific and supplementary grants. This leaves Metropolitan Police GRE and total expenditure unaltered. (Mr Hickson's letter of 30 March to Mr Brook gives the details.)

### Careers Service Strengthening Scheme grant

-----

We have assumed that this grant amounts to £13m (as indicated in the Secretary of State for Employment's letter of 17 July 1987 to the Chief Secretary) and that its inclusion in AEG increases current and relevant expenditure and the total of specific and supplementary grants by that sum: total expenditure and GRE are unaffected.

Effect on AEG percentage  
-----

The net effect of adjusting the 1988/89 settlement for these three changes is to reduce the AEG percentage from 46.2% to 44.7%:

	Settlement	Adjusted settlement	Adjustment
	-----	-----	-----
Relevant expenditure	£29,846m	£29,047m	-£799m
AEG	£13,775m	£12,976m	-£799m
AEG %	46.2%	44.7%	-1.5%

The composition of the net adjustment to relevant expenditure and AEG is:

Polytechnics	-£832m
INS	+£20m
Careers SSS	+£13m
	-----
Total	-£799m

FLGR3 17 May 1988

EXPENDITURE AND GRANT TOTALS 1988/89 AND 1989/90 OPTION 2 SETTLEMENT

Expenditure	1988/89 settlement (£m)	1988/89 adjusted settlement (£m)	1988/89 budgets (£m)	1988/89 adjusted budgets (£m)	1989/90 Option 2 settlement (£m)
Education	13,420	12,685	13,762	13,022	13,497
Police	3,350	3,370	3,426	3,446	3,679
Other	10,768	10,781	11,385	11,398	11,914
<b>Total current expenditure</b>	<b>27,538</b>	<b>26,836</b>	<b>28,573</b>	<b>27,866</b>	<b>29,090</b>
Contributions to special funds etc	-483	-483	-567	-567	-567
Other RCCO	387	387	372	372	434
Loan charges (including Leasing)	2,757	2,660	2,791	2,693	2,742
RFRACs to HRA	279	279	343	343	343
Interest receipts	-632	-632	-650	-650	-665
<b>Total relevant expenditure</b>	<b>29,846</b>	<b>29,047</b>	<b>30,862</b>	<b>30,057</b>	<b>31,377</b>
Non-relevant expenditure	289	289	271	271	312
Specific and supplementary grants	-3,566	-3,599	-3,500	-3,533	-3,843
Non-total storms expenditure	-	-	-2	-2	-
<b>Total total expenditure</b>	<b>26,569</b>	<b>25,737</b>	<b>27,631</b>	<b>26,793</b>	<b>27,846</b>
<b>Total grant-related expenditure</b>	<b>26,006</b>	<b>25,174</b>	<b>26,006</b>	<b>25,174</b>	<b>27,206</b>
Unallocated margin	563	563			640
Unallocated margin on services	1,117	1,117			1,200
<b>Grant</b>					
AEG percentage	46.2%	44.7%	42.7%	41.2%	44.7%
Aggregate Exchequer grant	13,775	12,976	13,188	12,389	14,026
Specific & supplementary grants	-3,566	-3,599	-3,500	-3,533	-3,843
Rate Support Grant	10,209	9,377	9,688	8,856	10,183
Domestic rate relief grant	-727	-727	-727	-727	-737
Block grant	9,471	8,639	8,950	8,118	9,435
Rate rebates	1,340	1,340	1,340	1,340	1,500
AEG plus rate rebates percentage	50.6%	49.3%	45.7%	45.7%	49.5%

Note

Adjustments to 1988/89 settlement and budget figures are for removal of polytechnics from LA sector and inclusion of INS and Careers Service Strengthening Scheme grants in AEG



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ANNEX  
B

M C Scholar  
Deputy Secretary

E A J George Esq  
Bank of England  
Threadneedle Street  
LONDON EC2

19 May

Dear Eddie,

INDEX-LINKED GILTS AND THE RPI

1. As you know, we have been giving thought to the appropriate way in which the RPI should reflect the abolition of local authority domestic rates first in Scotland, and, on the assumption that the Government's proposals for England and Wales become law, subsequently in England and Wales.

2. There appears to be three main possibilities, though the precise details of each could vary somewhat.

Option 1

(i) The level of the domestic rates indicator in the RPI would drop a little in April 1989 when domestic rates are abolished in Scotland, and then fall almost to zero when domestic rates are abolished in most of England and Wales. The rates indicator would drop further as rates were phased out in 10 London Boroughs in the years to 1994, and finally would reflect only the retention of rates in Northern Ireland.

(ii) The RPI weight for the rates indicator would, following past practice, be adjusted each January in line with spending in the preceding year. Therefore with rates abolished in Scotland in April 1989 and in most of England and Wales in April 1990 the weight for rates would retain the relatively high value it had in the preceding January for the remainder of each of these years.

(iii) This option would produce a step reduction of about 0.2 per cent in the RPI in April 1989, a further step reduction of 3½ per cent in April 1990, and very small further reductions as domestic rates were phased out in the London boroughs.

(iv) The Community Charge would not be included in the RPI, on the basis that it is, like a direct tax such as income tax, not related to the consumption of a specific service, unlike rates which have always been treated as a housing cost, because they are an indirect tax on housing services, and as such have been included in the housing component since the inception of the RPI. Referring to income tax and certain other payments which are excluded from the RPI, the RPI Advisory Committee noted as long ago as 1956 that certain expenditure is excluded from the (weighting pattern of the) index "because of the variable and non-measurable nature of the services acquired in return for the payments made and because of the difficulty or impossibility of identifying a 'unit' the price of which could be measured from date to date".

### Option 2

(v) The domestic rates indicator would be treated as in (i) and the Community Charge not included. But the weight for local authority rates would be adjusted in advance of each stage of their abolition in Great Britain. This prior adjustment of the weight for domestic rates would avoid major discontinuities in the level of the RPI by reweighting the rates contribution on the basis of known information in advance of major changes, in January of each year, between 1989 and 1994 as rates are abolished in Scotland and then in England and Wales.

### Option 3

(vi) As the indicator for domestic rates fell to reflect their abolition, as described in (i), the Community Charge would be included in the RPI between April 1989 and April 1994. The inclusion of the Community Charge as domestic rates disappeared in particular areas would be likely at that point to raise the level of the RPI somewhat because "index households" - which do not include the richest 4 per cent of households and pensioners - will pay a relatively higher proportion of the Community Charge than of domestic rates. Thereafter the effect on the RPI of including the Community Charge would depend on the extent to which the Community Charge rose faster or slower than the rest of the index.

3. Under the prospectuses for index-linked gilts the Treasury would be required to offer holders of index-linked stock the right of redemption if there were any change in the "coverage or basic calculation" of the index which, in the Bank's opinion, constituted "a fundamental change in the Index which would be materially detrimental to the interests of stockholders". It would be most helpful to us to have some indication of the view the Bank would be likely to take of the above three possibilities. Please could you let us have a view by Friday 3 June, or as soon as possible thereafter?

*Yours sincerely,*

*Michael*

M C SCHOLAR

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MARKET SENSITIVE

RETAIL PRICES INDEX AND COMMUNITY CHARGE:  
INDEX-LINKED GILTS

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INSTRUCTIONS

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- Enclosure 1: 2 Per cent Index-Linked Treasury Stock 1996 Prospectus
- Enclosure 2: Retail Prices Index - Current Composition
- Enclosure 3: Local Government Finance Bill
- Enclosure 4: "Method of Construction and Calculation of the Retail Prices Index"
- Enclosure 5: "Methodological Issues Affecting the Retail Prices Index"
- Enclosure 6: CSO draft paper: "Definition and Classification of Taxes in the United Kingdom National Accounts: Treatment of Proposed Community Charge"
- Enclosure 7: D/Emp draft paper: "Treatment of Rates and the Community Charge in the RPI"
- Enclosure 8: Treasury note "The treatment of LA rates and the CC"

1. The Law Officers and Treasury Counsel are asked to advise on the implications under the prospectuses for index-linked gilts of the change from rates to the community charge. All such prospectuses contain a provision (paragraph 23 of Enclosure 1) which states that "if any change should be made to the coverage or to the basic calculation of the Index which, in the opinion of the Bank of

ANNEX  
C

England, constitutes a fundamental change in the Index which would be materially detrimental to the interests of stockholders" the Treasury must give stockholders the option of redemption before the revised index becomes effective for the purposes of the prospectus. Domestic rates have been included in the RPI from its inception under the heading of housing (Enclosure 2). The treatment of the community charge in the RPI has not yet been determined but the options now being considered raise the question of whether they involve a change in the coverage or basic calculation of the Index.

2. There is no comprehensive statutory definition of rates but a useful description is to be found in section 519(4) of the Income and Corporation Taxes Act 1988. The community charge is established under the Local Government Finance Bill (Enclosure 3) currently going through Parliament. The scheme of the proposed legislation is that domestic rates should be replaced by three types of community charge: the personal community charge, payable by those who have their sole or main residence in the area of the relevant authority; the standard community charge, payable on second homes; and the collective community charge, payable by landlords of premises used by individuals as their sole or main residence for short periods. These charges differ from domestic rates in that they are flat rate per capita taxes rather than property taxes levied by reference to the value of the property in question. The charges are however similar to domestic rates in that the proceeds are applicable for public local purposes and that different local authorities can set the charge at different levels.



# CONFIDENTIAL

3. Referring to income tax and certain other payments that are excluded from the RPI the 1956 Advisory Committee (Paragraph 24 of Enclosure 5) said "most expenditure [of this type] is excluded from the weighting pattern because of the variable and non-measurable nature of the services acquired in return for the payments made and because of the difficulty or impossibility of identifying a "unit" the price of which could be measured from date to date (see para 7 of Enclosure 4)". It has in the past been suggested that rates should be excluded from the RPI (para 41 of Enclosure 5) as they are a form of local taxation, rather than a direct payment for services provided. It has been concluded however that as the taxation is on the occupation of property, it is appropriate to include it as a housing cost, just as other expenditure taxes are included as a cost of the product or service to which they relate. Rates are therefore included in the RPI as are VAT, excise duty, TV licences and vehicle excise duty (which, like rates, is separately listed in Enclosure 2) and the principle was reaffirmed in 1987.
4. The community charge is not related to the consumption of a specific service - unlike rates which are assessed on the rental value of a particular property - and it should, according to the principles outlined above, be excluded from the RPI. The Central Statistical Office are for the same reasons minded not to classify the community charge as a tax on expenditure, which is how they classify rates, and are considering drawing a new distinction in the national accounts between direct taxes, which will include the community charge, and indirect taxes, which would include rates (Enclosure 6).

5. Omission of the community charge from the RPI would however raise serious problems. Not only has the Government gone to some pains to present the community charge as a payment for services, rather than a poll tax, but omission of the community charge from the RPI would mean that the level of the RPI was significantly reduced from what it would otherwise have been. The Department of Employment have drafted a paper (Enclosure 7) in which they set out the various issues and suggest three main options as to how the community charge should be treated in the RPI.

Option A substitutes the community charge for rates. It is estimated that this would have the effect of raising the level of the RPI in April 1990, when the community charge takes effect in most of England and Wales, by about 0.25%. Thereafter, the RPI is expected to increase faster under this option than under Options B or C or indeed than it would have increased had the system of rates remained in place.

Option B would omit the community charge from the RPI but in such a way as to avoid any major discontinuity. Thereafter the RPI would be expected to rise more slowly, perhaps by 0.1 to 0.2% per annum, than under option A. The change would also probably be disadvantageous in comparison with the present rating system.

Option C would not include the community charge in the RPI and would reduce rates to near zero in April 1990. This would lead to a step reduction of about 4% of the RPI in 1990. Thereafter, as with Option B, the RPI would be expected to grow more slowly than under Option A or under the present rating system.

6. As indicated in paragraph 3 of these Instructions the purist choice among these options from the statisticians' point of view would be Option C. It would be irrelevant,, according to this argument, that Option C involves the loss of a component of the Index and thereby significantly reduces its level. Such a change would not be a change of coverage within the meaning of the indexed gilt prospectus, despite its admittedly significant effect on stockholders, any more than the abolition of VAT or VED and the substitution of higher rates of income tax, or the disappearance from the index of some product no longer bought by households, would involve a change in coverage. Taxes, it would be argued, have only been included in the RPI to the extent that they represent part of the price of products and services covered. Rates are included in the RPI as a cost of housing, not as the cost of local government services, and since the community charge is not levied by reference to the value of the property or the consumption of specific services which can be measured it can have no place in the Index.
7. According to this view, option A, unlike Option C, involves a change in coverage of the RPI since a type of expenditure would now be brought in which previously had been excluded under the principles referred to at the beginning of paragraph 3 of these Instructions. However, since the change would be expected to be beneficial to stockholders in comparison either with Options B or C the redemption clause in the indexed prospectus would not be triggered.
8. Option B, despite omitting the community charge from the Index, would according to this view also involve a change in coverage or basic calculation since it necessarily involves either taking rates out of the RPI at a time when they are still being paid, or compensating for their removal from the index by adjusting

their weighting within the index at a different time from usual (see Enclosure 8). But, if the analysis above is correct, although Option B constitutes a change in coverage, it could not be held to be detrimental to stockholders, since they would be better off under this Option than under Option C, which is the proper point of comparison.

9. Against this it might be represented that Option B was indeed a change detrimental to stockholders, because they would be worse off than they would be under Option A, or than under continuation of the existing system of rates. But this argument does not appear to be well founded: Option A is an irrelevant point of comparison, since it represents neither the status quo nor the new situation on the existing rules. Nor is there any reason why the proper point of comparison should be a hypothetical and artificial projection of what the RPI would have been had the rating system continued.
10. It is possible that a version of Option B may be devised (see paragraph (2) of Enclosure 8) which could be represented as involving only minor and technical changes to the method of calculation, and which might be held to be within the spirit of the present method of calculation. If so, it might be that the Bank would be able to conclude that, although a change had been made, it did not represent a fundamental change. Since this is at the moment hypothetical the Law Officers and Treasury Counsel are asked to ignore the possibility for the purposes of these Instructions, subject to the following point. If a change can be devised which is not "fundamental" from the statistical point of view it will still be "materially detrimental" to stockholders if compared with Option A or an index based on the continuation of rates. This therefore raises the question, which is of wider interest to the Treasury and on which they would

welcome advice, as to whether a change which is materially detrimental to stockholders can be anything other than fundamental for the purposes of the prospectus. If the answer to this question is that it cannot, the word "fundamental" in the prospectus seems redundant: on the other hand it appears difficult to argue that a change which is materially detrimental is not fundamental.

11. There is of course a way of looking at the options under consideration which is very different from that advanced in paragraphs 6-8. It could be argued that, whatever the statistical justification for the inclusion of rates in the RPI, its effect is to include local government taxes or, to put it another way, a substantial proportion of the cost of public local services in the coverage of the Index. The abolition of rates will not mean that local government taxes are abolished or that public local services cease to be financed from such taxes. If the community charge is omitted from the Index, so this argument runs, there is a clear change in its coverage, which is evidenced by the change in the projected level of the Index. According to this view, both Options C and B would mean that the first precondition of the redemption provision in indexed gilt prospectuses was satisfied and that the only question was whether, in the Bank of England's view, this would have a detrimental effect on stockholders. There is little doubt that the Bank of England would conclude that either option would indeed have such a detrimental effect. Indeed it is also thought likely that the Bank would adopt the view expressed in this paragraph and conclude that both Option B and Option C constituted a change in coverage or basic calculation. Subject to the advice of the Law Officers and Treasury Counsel, it is not however thought that their view on this, as opposed to their view on whether the change is fundamental or materially detrimental to

stockholders, is strictly relevant to the prospectus. The test of whether or not there has been a change in coverage or calculation appears to be objective not subjective.

12. The questions on which the advice of the Law Officers and Treasury Counsel is sought are therefore:

- (1) Can the Treasury safely argue (a) that Option C does not involve any change in the coverage or basic calculation of the RPI, (b) that the prospectus does not allow a plaintiff to argue that this is a matter on which the Bank of England's opinion is to be given and (c) that Option C does not therefore trigger the option of redemption?
- (2) Would Option B also avoid triggering the gilts redemption provision on the basis that, although it constitutes a relevant change within the meaning of the prospectus, the detriment to stockholders would have to be compared with a situation (ie Option C and not Option A) which the Law Officers and Treasury Counsel are informed would be regarded by the Bank of England as more detrimental still?
- (3) Irrespective of the answer to (2) and the facts of this case, could there theoretically be a change in the coverage or calculation of the RPI which was materially detrimental to stockholders but not "fundamental" for the purposes of the redemption clause?

13. The Law Officers and Treasury Counsel will appreciate that if option C or B is followed and there is subsequently a successful challenge to the decision not to offer redemption, the consequences could be severe. Although there is a 7 months time lag under the prospectus (paragraph 15 of Enclosure 1) before a change in the Index takes effect for the purposes of the prospectus, a decision on how the Index should be calculated would in practice be irrevocable once Index figures based on this decision had been generated. The relevant index for calculation is the one that has been published (paragraph 5 of Enclosure 2). The Government could not therefore reverse a decision on how the Index was to be calculated in the light of proceedings during the 7 month period. Moreover it is thought impractical, in view of the uncertainty and disruption which would be caused in the gilt-eded market, for the court to be asked to make a declaration about the implications for the prospectus of the community charge in advance of any RPI figures being generated under the new system, even if such proceedings were theoretically possible. In other words, the Government would have to make a once and for all choice of option B or C and accept any associated risk of the redemption of index-linked gilts. Since this redemption would cost about £2.8 billion (as measured by the difference between the redemption cost and current market value of the stock) Ministers will, if advised by the Law Officers and Treasury Counsel that Options B and C do not require redemption, be anxious to know the sort of odds which would apply if the matter went to court. The difficulty of predicting the outcome of litigation, particularly in the absence of the evidence which would then be available (including a report from the RPI Advisory Committee), is of course well understood and it is accepted that any estimate would need to be revised in the light of such further information.

**PROSPECTS FOR LOCAL AUTHORITY FINANCES****Introduction**

The Community Charge (CC) will be introduced in Scotland in April 1989 and in England and Wales in April 1990. This note explores the prospects for CC in the context of projections of local authority income and expenditure for the next 3 years. The focus is on both the prospects for CC income in aggregate and also on implied year-on-year changes in the average per capita charge. Most of the figuring is for Great Britain as a whole, but where necessary separate assumptions are made for Scotland on the one hand and England and Wales on the other. As far as we know this is the first attempt to examine the level of CC in 1990-91 - other analyses, for example by the DOE, merely illustrate the level of CC implied by current levels of LA spending.

2. The results depend on a number of crucial assumptions and are very uncertain. The uncertainties relate not just to the period after CC is introduced but also to behaviour beforehand. In view of this, one possible alternative scenario - involving different behaviour in 1989-90 and 1990-91 - is presented. In addition some calculations at the end of the note show the sensitivity of the prospects for CC to various changes in assumptions about behaviour in 1990-91.

**Current income and expenditure**

3. The future course of CC depends mainly upon the future course of

LA current expenditure,

income from business rates

and grant (AEG) receipts from central government.

It also depends on the extent to which current expenditure is covered by current income ie from grant, rates and the CC. Any shortfall (or longfall) involves a running down (or up) of rate fund balances. Changing balances is only a temporary expedient income and expenditure. The outcome is also dependent on LAs' use



of special funds. These funds lie outside the rate fund account and can be used by authorities as a creative accounting device to change the level of relevant expenditure for grant purposes, without changing actual expenditure.

4. The projection of LA expenditure is built-up from separate assumptions about numbers employed, earnings increases -75 per cent of current expenditure goes on pay - procurement expenditure, interest payments etc and then checked for overall plausibility. Within this, it is assumed that the additional manpower to implement CC adds some £100 million to LAs' pay bills from 1989-90. This increase is consolidated in the first year of CC when there will be additional costs from other initiatives such as the national curriculum and abolition of ILEA. One factor, which this work has not attempted to allow for, is the effect of competitive tendering. It is possible that this could result in the provision of LA services at lower cost, thereby holding down the growth of expenditure in real terms.

5. The projection assumes full indexing of business rates in line with the RPI and that the business rate base will be rising somewhat faster than over the recent past, reflecting strong growth of business investment in property.

6. The proportion of LA expenditure financed by central government grant has been falling in recent years as a result of the Government's attempts to rein back LA spending. Under the present system grant is withheld if authorities overspend, but there is no provision in the new system for grant penalties. The Government's commitment that the level of CC per household in each local area in 1990-91 will be broadly no higher in real terms than rates per household in 1989-90 if the local authority expenditure is unchanged in real terms, effectively means that the level of AEG in 1990-91 should not rise in real terms from outturn (after grant penalties) in 1989-90. However, the projection assumes that the amount of grant paid in 1990-91 is such that the grant percentage in that year will be at least as high as in 1989-90 before penalties. As grant penalties are expected to reduce the actual grant percentage by about one percentage point in 1989-90 an unchanged percentage before penalties implies a one point rise in the actual grant percentage in 1990-91. But at the moment the

risk appears to be that if anything the grant percentage could be higher than assumed. A small further rise in the grant percentage in 1991-92 is assumed.

7. Some attempt has also been made to allow for the effect of the distribution of grant among individual authorities on the levels of aggregate expenditure and CC. Under the transitional arrangements for England which last from 1990-91 to 1994-95, and simplifying a little, authorities in the "south" gain grant at the expense of those in the "north and inner London". This redistribution could well push up aggregate levels of both expenditure and CC. Authorities in the "south" rather than maintaining spending and having a lower CC than otherwise would be able to boost spending without having to raise more CC to finance it. Authorities in the "north and inner London" might maintain expenditure, rather than cutting it to match the lower grant, by increasing the CC and blaming central government.

8. There could well be significant shortfalls in **CC receipts** due partly to evasion and partly to LAs' inability to collect receipts from people on the register. It is assumed that the authorities' anticipate a 5 per cent shortfall when setting the charge for 1990-91 but that in the event the shortfall is larger at 10 per cent. The unexpected additional 5 per cent shortfall is assumed to be financed by a run down in balances. It is assumed that the unexpected shortfall is a little smaller in 1991-92 and that the authorities again run down balances.

9. The future course of local authority current expenditure and receipts, on the various assumptions stated above, is summarised in table 1. Current expenditure grows at around 4 per cent a year in real terms from 1989-90, more than the unusually low increase which seems in prospect for 1988-89, but not very different from earlier years. In 1990-91 grant income rises more, and CC income less, in real terms than expenditure. In 1991-92 grant rises a little faster than expenditure but with business rates rising by less than 2 per cent in real terms there is a relatively large increase in real CC income.

**Table 1: Local Authority Current Account Expenditure and Receipts**

<u>PES terms, GB</u>	<u>£ billion</u>				
	<u>1987-88</u>	<u>1988-89</u>	<u>1989-90</u>	<u>1990-91</u>	<u>1991-92</u>
<b><u>Expenditure</u></b>					
Total relevant expenditure	35.0	37.3	40.7	44.2	48.0
Total current expenditure	35.3	37.6	41.1	44.6	48.4
<b><u>Receipts</u></b>					
Grant (cash)	16.3	16.7	18.1	20.1	22.1
Rates	18.8	20.5	22.0	13.6	14.3
of which:					
Domestic	8.8	9.6	9.7	0.4	0.3
Non-domestic	10.0	10.9	12.2	13.2	14.0
Community charge	-	-	1.0	10.6	11.6
Drawings from balances	0.3	0.4	0.0	0.3	0.5
Total finance	35.3	37.6	41.1	44.6	48.4
Grant percentage (accruals)	45.6	44.8	44.5	45.5	46.0
	<b><u>Annual percentage changes</u></b>				
<b><u>Cash</u></b>					
Total current expenditure	8.8	6.5	9.3	8.5	8.6
Grant	9.4	2.9	8.4	11.0	9.8
Rates & community charge	8.0	9.3	11.7	5.4	6.9
of which:					
Domestic	8.0	9.3	10.9	2.4	8.0
Non-domestic	8.0	9.3	12.4	8.1	6.0
<b><u>Real terms</u></b>					
Total current expenditure	3.4	0.8	3.8	4.3	4.3
Grant	4.0	-2.7	3.0	6.7	5.5
Rates & community charge	2.7	3.4	6.2	1.4	2.7
of which:					
Domestic	2.7	3.4	5.4	-1.5	3.7
Non-domestic	2.7	3.4	6.8	3.9	1.8

Capital Account and Borrowing

10. The main feature of the recent past is the unexpectedly high level of capital receipts - for example from council house sales and repayment of LA mortgages - in 1987-88. It is assumed that receipts are maintained at the 1987-88 level in real terms. Gross capital expenditure - ie. acquisition of capital assets - is assumed to rise by 1 per cent a year in real terms.

11. The projection of LA borrowing - the LABR - in 1988-89 gives weight both to the projections of LA income and expenditure and to the outturn for borrowing in the first two months of the year. The latter suggests higher borrowing than the former. Thereafter, the LABR merely mirrors projected movements in the balance of income and expenditure.

## LABR - £ billion

1987-88	1988-89	1989-90	1990-91	1991-92
1.5	2.0	1.5	2.1	2.4

The rises in borrowing in 1990-91 and 1991-92 can be seen as partly reflecting the assumed unexpected shortfall in CC receipts. It also reflects the assumption that net capital spending will rise in real terms.

Rates of Increase of Domestic Rates and CC

12. Table 2 shows the growth of domestic rates and CC, taken together, expressed in three different ways:-

- a. the growth in aggregate LA receipts from domestic rates and CC, as in table 1;
- b. the growth in domestic rates and CC per (non-exempt) adult; ie as if domestic rate prior to 1990-91 had been distributed equally among those liable to CC;
- c. the growth in domestic rates and CC per household; ie as if CC payments were distributed equally among only those liable to rates.

Table 2: Domestic Rates and CC

	<u>annual percentage changes</u>				
	<u>1987-88</u>	<u>1988-89</u>	<u>1989-90</u>	<u>1990-91</u>	<u>1991-92</u>
Total LA income	8.0	9.3	10.9	2.4	8.0
Per household	6.6	7.8	9.3	0.8	6.2
Per adult	7.2	8.7	10.3	1.9	7.4
Memo: increase in total RPI (%)	4.0	5.0	5.8	4.1	4.0
Average level of CC per head*(£)	-	-	279	279	300

\* Assuming that it is set on the assumption of 5 per cent non-payment; 1989-90 is average for Scotland only - other years are averages for GB.

13. The per capita figures are based on the forecast of the adult population provided by the Government Actuary's Department (GAD). It is assumed that a constant 3 per cent of the adult population is wholly exempt from the charge (treating partly exempt persons as four-fifths exempt).

14. The treatment of the CC in the RPI is not yet decided. Lines 2 and 3 of table 2 gave some indication only of how the CC component of the RPI might behave, if it were decided to include it. They suggest real reductions in 1990-91, when the charge is introduced in England and Wales but sizeable real increases in 1991-92. But it is important to note - see table 4 below - the transitional effects on the RPI of the ending of domestic rates and introduction of CC. These are likely - if the CC were included in the RPI - to increase the RPI because the burden of rates falls more on richer households excluded from the RPI while the burden of CC is more evenly distributed and therefore higher on households whose expenditure is used for compilation of the RPI.

#### Variant

15. This variant explores what might happen if authorities make greater attempts, through creative accounting in the run-up to CC, to maximise their grant entitlement, with the effects being unwound in 1990-91, increasing expenditure in that year. Although most creative accounting devices have been blocked, one that remains is the use of so-called special funds. When an authority

runs down its special funds the effect is to reduce relevant expenditure in PES terms for given purchases of goods and services, which may reduce grant penalties. But under the new grant system there will be no grant penalties and therefore no incentive for authorities to use special funds in this way.

16. Special funds are currently estimated at about £1.1 billion. If authorities respond to the reforms by running these down over the next two years the effect will be to reduce relevant expenditure in the period before CC but then to produce a step-up in relevant expenditure in 1990-91. The magnitude of these effects is highly uncertain. For illustrative purposes table 3 shows the result of £400 million less relevant expenditure in 1989-90 and £1 billion more in 1990-91 and 1991-92, with the remaining assumptions unchanged.

**Table 3: Summary of Variant**

	<u>Annual percentage changes in real terms</u>				
	<u>1987-88</u>	<u>1988-89</u>	<u>1989-90</u>	<u>1990-91</u>	<u>1991-92</u>
<u>Current expenditure</u>					
main case	3.4	0.8	3.8	4.3	4.3
variant	3.4	0.8	2.8	7.7	4.1
<u>Grant</u>					
main case	4.0	-2.7	3.0	6.7	5.5
variant	4.0	-2.7	1.9	10.2	5.3
<u>Domestic rates &amp; CC</u>					
main case	2.7	3.4	5.4	-1.5	3.7
variant	2.7	3.4	4.3	5.2	3.4

**Sensitivity of CC to Alternative Assumptions**

17. As a further indication of the sensitivity of the figures in table 2 to the underlying assumptions, table 4 gives changes in rates/CC in 1990-91 under a range of alternative assumptions about behaviour in that year:

1. reduction in balances of £500 million instead of £250 million;
2. no change in balances (ie. £250 million less drawing);

3. increase in balances of £250 million compared to a reduction of £250 million in the main case;
4. 1 per cent faster growth in current expenditure (for given grant);
5. grant one per cent higher.

In each case only one assumption is changed. For example case 5 shows the effect of higher grant for given expenditure and balances.

Table 4: Community Charge in 1990-91 - alternative cases

	<u>Annual percentage change</u>					
	Main Case	Case 1 (Variations in balances)	Case 2	Case 3	Case 4 (more expend)	Case 5 (more grant)
Total income	2.4	0.2	4.6	6.8	6.1	0.6
per household	0.8	-1.4	3.0	5.2	4.4	-1.0
per adult	1.9	-0.3	4.1	6.3	5.6	0.1
CC per head*(£)	279	273	285	291	289	274
<b>RPI inflation 1990-91 on 1989-90</b>						
(i) Excluding rates and community charge from RPI**	3.8	3.8	3.8	3.8	3.8	3.8
(ii) Replacing rates by community charge***	4.0	3.9	4.1	4.2	4.2	3.9

\* Assuming 5 per cent non-payment

\*\* In this case rates are dropped from the RPI and are not replaced by community charge. It is assumed that rates are removed from the RPI in the January preceding April 1990, in order to avoid a spurious drop in the RPI when rates are abolished (and their "price" apparently falls to zero). Were this not done, there would be negative inflation in 1990-91.

\*\*\* Replacing rates by the community charge increases the rate of inflation in all cases, even in Case 1. This is because of the "index household" effect. A given increase in LA income impacts more heavily on the particular households covered by the RPI if it is raised by community charge rather than rates. This adds 5 per cent to the increase in the rates/community charge indicator in the year community charge is introduced.

18. Variations in balances (cases 1 to 3) come through one for one on CC in absolute terms. A £250 million difference in balances is worth about 2 percentage points on the growth of CC. The more authorities run down balances to finance expenditure (cf case 1 with main case) the smaller is the increase in the CC. Running down balances is however not a long term option, only a temporary expedient. Over time LAs have by law to balance income and expenditure.

19. Table 4 shows also the high gearing between changes in expenditure and grant and changes in CC ie. given proportionate changes in expenditure and grant have larger proportionate effects on CC. In the case of changes in expenditure (for given grant) the gearing is about 1 to 4 because CC finances about 25 per cent of expenditure. In other words a 1 per cent increase in expenditure produces a 4 per cent increase in CC.

20. The gearing between changes in grant and CC is 1 to 2; a 1 per cent increase in grant produces a 2 per cent reduction in CC. This is because grant income is roughly twice CC income.

### Conclusions

21. There are perhaps two main conclusions:

- (i) due to transitional effects the rate of increase of the burden of domestic rates and CC could be quite different in 1990-91, the year CC is introduced in England and Wales, from subsequent years. It is possible that the burden could rise by a relatively small amount (or even fall) in the first year of CC in England and Wales;
- (ii) all the assumptions are uncertain and the figuring is very sensitive to changes in assumptions. Sensitivity analysis shows that it is possible, by varying the assumptions in not unreasonable ways, to produce projections which range from a large real increase in the burden of domestic rates and CC to a sizeable real reduction. These projections largely turn on decisions



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which will be made by Ministers and by local authorities over many years which cannot, by their nature, be forecast at this stage.

27 June 1988



prop

personal

not to be copied

FROM: A C S ALLAN

DATE: 19 May 1988

to  
anyone

CHANCELLOR

**RSG SETTLEMENT 1989-90**

m.

A few fairly basic points - but there's quite a lot at stake in negotiating the technical details fiercely.

2. Mr Ridley will fight very hard to maintain the grant percentage. I doubt we will get it down by more than a token amount - and then only if we can dream up some technical justifications.

3. This points to being as mean as possible on provision. Mr Ridley will be reasonably sympathetic, though service Ministers will be very difficult. They will be able to argue - with justification - that this is presentationally disastrous for them: we set their provision at levels we know cannot be achieved; they get criticised for "cuts"; and then we complain about local authority "overspending".

4. But while we are stuck with the grant percentage - and the present planning total - we just have to put our heads down and bash away at provision. Roll on the new planning total!

5. The tone of Ridley's paper makes it seem as if he might accept provision at a 1 per cent real terms cut on 1988-89 budgets. I think we should go for that. As a matter of tactics, we might insist that Ridley's paper includes a fourth option, with provision at a 2 per cent real terms cut on 1988-89 budgets.



6. A 1 per cent real term cut with a constant grant percentage is essentially the option discussed in Fellgett's note of 11 May. I can't say it's very attractive - £880 million more grant, a 6.8 per cent increase. So we should combine it with being very tough on the "unallocated margin", which should produce a substantial grant underclaim. We certainly should not buy Ridley's proposal of an allocated margin set at the same percentage of provision as last year - that implies an enormous increase in GRES (8% on my rough calculations), which are supposed to measure local authorities "needs". An appalling signal.

7. On tactics, I am sure we should start by proposing a reduced grant percentage. The original proposal in Fellgett's note of 5 May - starting with an option which produces an increase in the grant percentage - is suicidal. Ridley would pocket it at once.

8. Two other points

- (a) where is the further advice on fixing grant three years' ahead?
- (b) we certainly cannot accept Ridley's "objective" of "providing Government support for 50% of local spending needs in the new system".

A C S ALLAN



MINUTES OF A MEETING HELD IN CHANCELLOR'S ROOM  
HM TREASURY AT 10.00AM ON FRIDAY 20 MAY

Those present

Chancellor  
Chief Secretary  
Mr Anson  
Mr Phillips  
Mr Turnbull  
Mr Potter  
Mr Fellgett

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**RSG SETTLEMENT 1989-90: TACTICS**

The Chancellor said that from the draft of Mr Ridley's paper it was clear that he attached great importance to maintaining the grant percentage at the present 44.7 per cent. The Chancellor thought it unlikely that we would in the end succeed in cutting this down at all, but a victory here for Mr Ridley might incline him to support a Treasury line elsewhere.

2. The Chancellor thought the Treasury priority should be to get as tough as possible a settlement on provision. As an opening position, he thought that we should ask DOE to include in their paper exemplifications of a fourth option - a 2 per cent real terms cut on 1988-89 budgets - although in the end a reasonable Treasury objective might be to settle at Mr Ridley's Option 3. On the high spending assumption, this would produce rate increases of 7½ per cent - the same as, or lower than, average rate increases this year. Overall, it would be a pretty generous settlement from the Treasury's point of view - £880 million more grant, a 6.8 per cent increase. So it would be important to be as tough as possible on the unallocated margin: Mr Ridley's proposal that it should be the same percentage of provision as last year implied a massive rise in GRES, <sup>which would give</sup> a very odd signal, and would mean that outturn grant rose even faster than grant at Settlement. The Chief Secretary said that he would consider with officials how far the Treasury could hope to squeeze GRES.

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3. There were a number of other points on which the Chancellor thought it would be worth challenging Mr Ridley. First of all, we could not accept the assertion that the Government had an "objective" of providing support for 50 per cent of local spending needs in the new system. This line had been developed independently by DOE Ministers, as an illustrative assumption, and had not been collectively endorsed as an objective. Secondly, it seemed very odd to propose to reduce the number of rate-capped authorities from 17 to 7. Under the community charge, it seemed quite likely that we would need to increase the number of capped authorities, and it was therefore perverse to draw back on this now. We should ask to see the legal advice on which the DOE proposal was said to be based.

4. The Chancellor noted that Mr Ridley was arguing for high grant in order to keep rates low in the year before the community charge was introduced. This was a perverse approach. Instead, we should be keeping rates at a level where everyone would be glad to see the end of them. Any easing should coincide with the introduction of the community charge, rather than precede it.

5. The Chancellor asked whether others saw advantage in making a move to settle three years of forward grant this year. It might be argued that the time was not yet right, but he felt that next year might be even worse. The pressure for grant generosity in 1990 was unlikely to be seen off completely, so the question was whether we would gain from fighting for a three year settlement this year. Was it better to have a baseline than to have none at all? Mr Potter thought that there might be attraction in negotiating grant for Years 2 and 3 separately in September or October. This would tie in with settling the transitional safety net, where DOE had said that the grant and NNDR would be set at a level such that local authorities only had to raise the same amount in community charge as they had raised from domestic rates in 1989-90. The Chancellor noted there was a clear downside to this: the more we linked the first year of the community charge with this year's rates, the more force there would be in Mr Ridley's arguments that this year the rates should be held down by increasing grant. If

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Mr Ridley won that argument, it would not stop him coming back and looking for further easing in 1990. Mr Fellgett added that the transitional arrangements were already generous - in 1990-91 there would be no under-claim because of local authority over-spending, and so we would pay out the full settlement grant.

6. The Chief Secretary said that he agreed with this general strategy. We might well have to give Mr Ridley what he wanted on the grant percentage, as he was our only ally on provision. There might be advantage in sorting out something with Mr Ridley - even if this was not displayed to the full Committee - before approaching Mr Parkinson. Our other lines of attack should be:

- (a) fighting off the proposed reduction in the number of rate-capped authorities;
- (b) pressing for as large an unallocated margin as possible, in order to restrain the increase in GREs; and
- (c) looking again at the gap between provision and relevant expenditure, which might leave some scope for reducing the £880 million grant cost of Option 3 to a less unattractive level.

More generally, the case for restraint could be underlined by:

- (d) pointing to the priority that other areas, eg Health, must have in this year's Survey; and
- (e) comparing the actual rate increases that are taking place this year with the frightening predictions produced by DOE at E(LA) last year.

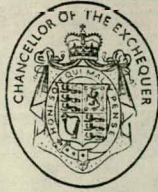
*Mpw*

MOIRA WALLACE

24 May 1988

Distribution

Those present  
Sir P Middleton  
Mr A J C Edwards (o/a)  
Mr Tyrrie



BF 2/6  
6/6  
9/16

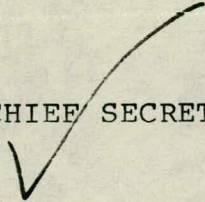
FROM: A C S ALLAN

DATE: 23 May 1988 PPS

cc Mr H. Phillips

Mr Fellgett

PS/CHIEF SECRETARY



1989-90 RSG SETTLEMENT

Please see the PPS' request in this minute. I would be grateful if you could advise, directing the advice via the CBT to the Chancellor

*J. Phillips*

At the meeting on Friday, Mr Potter and Mr Fellgett mentioned that various commitments had been made about how much councils would be expected to raise from the community charge in 1990-91 for a given level of spending (? a real terms freeze on 1989-90 budgets). The arithmetic was on the lines that grant would be set so that they were required to raise the same amount (in real terms?) from the community charge as they had from domestic rates in 1989-90.

2075

2. The Chancellor would be grateful if the Chief Secretary could commission advice on exactly how these arrangements would work, the extent to which we are firmly committed to them, and their implications (if any) for the 1989-90 settlement.

A C S ALLAN

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FROM: R FELLGETT

DATE: 24 May 1988

*(discussed @ CST prep)*  
*[Waterman]*

- 1. MR POTTER *discussed in draft*
- 2. CHIEF SECRETARY

*Ch*  
*This seems OK.*  
*AA*

cc Chancellor  
Sir P Middleton  
Mr Anson  
Mr Phillips  
Mr Turnbull  
Mr Call

1989-90 RATE SUPPORT GRANT SETTLEMENT FOR ENGLAND

We have now discussed the figuring underlying Mr Ridley's draft paper for E(LA) with DOE officials. We will work with them towards neutral tables, agreed between us so far as possible, that you and Mr Ridley can have in front of you at your meeting on 7 June.

2. For this purpose, we will need to propose further options for both AEG and expenditure provision. In the light of the Chancellor's meeting on Friday, and the figures as we now understand them, I suggest the following:

(i) two options for AEG - increases of £520 million and £620 million compared to the 1988-89 settlement (adjusted for polytechnics);

(ii) one option for provision, calculated as local authorities' own budgets for 1988-89, increased by 2%, adjusted for rate-capped authorities and the Metropolitan police, plus £100 million for Community Charge preparation costs.

3. An increase of £520 million in Aggregate Exchequer Grant would give about £13,500 million for the 1989-90 RSG settlement. This increase at settlement would be the same as the increase at outturn in 1988-89 (ie after allowing for underclaim in both 1988-89 and 1987-88). It could also be defended as flat in real terms; it represents an increase of 4%, like the FSBR GDP deflator for 1989-90. It appears significantly less than Mr Ridley's



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proposed increase of £1,050 million, and on the level of provision he favours it implies a reduction in the grant percentage from 44.7% to 42.9%. This could be your starting position. The fallback option of an increase in AEG of £620 million would then be an increase in line with inflation plus the full costs of preparing for the Community Charge. Mr Ridley might find an offer to pay the full costs from Exchequer funds quite attractive.

4. The three options in Mr Ridley's paper for provision allow for increases in expenditure over local authorities' own 1988-89 budgets of 5%, 4% (the GDP deflator), and 3%, plus the adjustments for rate-capped authorities and Community Charge preparation costs. Overall, they represent percentage increases on local authority budgets of about 5½%, 4½%, and 3½% respectively. The new option we suggest is about 1% lower. It would be your opening position, although the Chancellor noted at his meeting that you would eventually probably have to fall back to Mr Ridley's lowest option 3.

5. On this basis, your overall fallback would be an extra £620 million of grant and Mr Ridley's option 3 for provision. We believe there may be scope for squaring this with a grant percentage that is at least broadly unchanged from the 44.7% that Mr Ridley advocates in his draft paper. We would have to reduce the elements of relevant local authority expenditure that are not classified as public expenditure, and hence do not appear in the PEWP or have to be defended by service Ministers. DOE must be aware of this possibility. The additional options proposed above therefore have the advantage of hinting at such a compromise to Mr Ridley, who may be prepared to take it rather than go through a protracted haggle in E(LA).

6. The proposed fallback is slightly more generous than an increase in AEG of £550 million to £600 million, which we suggested earlier as your objective. We will also need to be careful that the detailed settlement assumptions do not lead to a significantly higher increase at outturn, because underclaim is substantially reduced. However, there seems very little prospect of Mr Ridley settling for anything less.

Need to be careful

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7. We will provide full briefing for your meeting with Mr Ridley later. I should now be grateful for your agreement to ask DOE to exemplify the options for provision and AEG suggested above.

*Robin Fellgett*

R FELLGETT



if possible

Ch

I would delay playing  
the card @ X — ~~probably~~  
till next year, & certainly  
until it is clearly  
needed this year — i.e. if  
arguments about the level of  
poll tax next year become  
a major feature of ECUA  
discussions this year.

I agree.  
Per [unclear]  
M  
[Signature]

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None committed to the words; much of how we interpret them is to be played for. HP.

FROM: R FELLGETT

DATE: 27 May 1988

1. MR PHILLIPS
2. CHIEF SECRETARY
3. CHANCELLOR

cc Sir P Middleton  
Mr Anson  
Mr Turnbull  
Mr A J C Edwards o/a  
Mr Potter o/r

## 1989-90 RSG SETTLEMENT

Mr Allan's minute of 23 May asked for advice on the commitments that had been made about what councils would be expected to raise from the full Community Charge in 1990 for a given level of spending.

2. The DOE yellow booklet on Paying for Local Government, published in August 1987 said:

"There will be a safety net designed to make sure that a local council will need to raise only the same amount from domestic rates plus Community Charge in 1990-91 as it raised from domestic rates in the previous year, provided that it spends the same amount in real terms in both years."

This is consistent with decisions on the safety net and transition taken in E(LF) in July 1987. Following the subsequent decision to amend the safety net slightly (and to introduce the Community Charge immediately outside inner London) an addition to the booklet said:

"The Government proposes to use a safety net to limit the speed at which Community Charge and ratepayers feel the effect of the move to the new system ... In 1990-91 there will be no change in the distribution of grant and non-domestic rates between areas, except that it is now proposed that contributions will be limited to a maximum of £75 per adult from any area. This will slightly reduce the extent to which other areas are able to gain from the safety net."

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3. These statements about the safety net reflect earlier proposals in the Green Paper "Paying for Local Government". They have not subsequently been updated or refined; DOE officials think (and we agree) that it would be prudent to keep local authorities guessing about the precise determination of the safety net arrangements, to reduce the scope for them to manipulate their accounts to obtain maximum benefit from it.

4. The first quote above is actually ambiguous about whether local taxes are intended to be unchanged in real or cash terms. DOE have, however, always accepted that it assumes both spending and local taxes are flat in real terms in 1990-91. This was implicit in the July E(LF) decision. In theory, it should be very helpful in the 1990-91 RSG settlement. Because business rate revenue will be broadly unchanged in real terms, it implies that actual payments of grant will also be flat in real terms. Grant in 1990-91 that was no higher in real terms than the outturn in 1989-90 (after an underclaim of perhaps £500 million) would be an incredible bargain in the first year of the Community Charge. In practice, a cash increase, compared to the settlement for 1989-90, at least as high as inflation seems almost unavoidable; at outturn, grant actually paid would then increase by the size of the underclaim in 1989-90 plus at least the GDP deflator.

5. Mr Ridley is nevertheless likely to deploy the argument in the 1989-90 RSG negotiations that the safety net arrangement means that grant in 1990-91 is effectively determined by the settlement for 1989-90. This would be consistent with his view that it is necessary to keep rates down in 1989-90 to prepare the way for the Community Charge. As you said at your meeting, that is the wrong way round; any generosity in grant should be in 1990-91 to enhance the appeal of the Community Charge. It may therefore be necessary to acknowledge in the E(LA) discussions that the safety net in 1990-91 could be more generous than an increase in grant at outturn in line with inflation would imply. But Mr Ridley should, presumably, have no difficulty accepting this point (which we are bound to concede anyway in due course). And in any case it will be necessary to acknowledge that grant might rise significantly in 1990-91 if we are to rebut Mr Ridley's view that grant should instead be generous in 1989-90.

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6. The announced safety net arrangements therefore seem to add a detail to Mr Ridley's argument that grant should be generous in 1989-90 to prepare the way for the new system, but do not fundamentally change the nature of his argument or the nature of the necessary counter-argument.

*Robin Fellgett*

R FELLGETT



*ppp for PNP*

FROM: ZOE EVEREST-PHILLIPS  
DATE: 1 June 1988

MR FELLGETT

cc:  
Chancellor  
Sir Peter Middleton  
Mr Anson  
Mr Phillips  
Mr Turnbull  
Mr Potter  
Mr Call

1989-90 RATE SUPPORT GRANT SETTLEMENT FOR ENGLAND

The Chief Secretary was grateful for your note of 24 May and is content with the line you propose to take with DOE.

A handwritten signature in black ink, appearing to read "Zoe Everest-Phillips".

ZOE EVEREST-PHILLIPS  
Assistant Private Secretary

CHIEF SECRETARY

FROM: B H POTTER

Date: 3 June 1988

cc: PS/Chancellor  
 Sir Peter Middleton  
 Mr Anson  
 Mr Phillips  
 Mrs Case  
 Mr Edwards  
 Miss Peirson  
 Mr Turnbull  
 Mr Fellgett  
 Mr Call

**MEETING WITH SECRETARY OF STATE FOR ENVIRONMENT: DISCUSSION  
 ON 1989-90 RSG SETTLEMENT**

I attach two briefing notes for your meeting next Tuesday with the Secretary of State for Environment on the 1989-90 RSG Settlement.

2. The first from Mr Fellgett provides a brief on the key features of the RSG Settlement, the quantum of grant and the provision for relevant public expenditure. My separate brief covers rate capping in 1989-90, in case this is raised in the discussions.

Tables for meeting

3. Attached are two tables, prepared by DOE officials and agreed with us, as the factual basis for your meeting with Mr Ridley. Table 1 describes the options as follows:

- on provision: options 1-4 (+ £1.6 billion; + £1.3 billion; + £1.1 billion; + £0.8 billion respectively above PEWP provision)

*Review to all  
 subject to all  
 un-sure with Mr. Phillips  
 before (LA) - He says on no  
 direction of this, too, whatever  
 his approach was in  
 admin.*



- on AEG: option A (DOE fixed grant percentage of 44.7%);  
option B an addition of £520 million at settlement.

Table 2 describes the impact of different combinations of grant and provision options on rate increases and the levels of Community Charge in 1989-90, for given assumptions about local authorities' spending behaviour.

Briefing line from DOE officials

4. Since Mr Fellgett's brief was prepared we have a clearer understanding of the line Mr Ridley is being briefed to take at the meeting. This is as follows:

- not to reach an agreement with you on either grant or provision;
- to see whether an understanding can nevertheless be reached that "extreme" options - that is options 1 and 4 on provision and option B on grant - can be dropped before Mr Ridley's paper goes to E(LA);
- to give no ground on the grant percentage argument;
- to accept there may be flexibility on the financing items within relevant expenditure (so that a lower quantum of grant can be consistent with a fixed grant percentage); but not to offer any particular amounts;
- not to discuss GREs, unallocated margins or rate limitation.

5. DOE officials' strategy appears to be to get our options on provision and grant off the table and then to rely on pressure from the spending Ministers in E(LA) to force up the provision figure to option 2. With a fixed grant percentage, that would increase grant at settlement by over £1 billion. However DOE officials have hinted that Mr Ridley might be reluctantly persuaded to accept option 3 on provision.

Line to take

6. If Mr Ridley takes the uncompromising line suggested by his officials, the meeting will not prove very helpful. You will not wish to offer any movement away from option 4 on provision and option B on grant. You should draw on the key arguments in Mr Fellgett's brief against the big injection of grant under Mr Ridley's favoured option - option 2 on provision, and option A on grant. In particular why push more grant in now in pursuit of popular low rate rises just when rates are being abolished? The very best that might be achieved from such a discussion would be some understanding that Mr Ridley might be prepared to adopt option 3 on provision and agree that the scope for squeezing the financing items (to square a lower quantum of grant with a fixed grant percentage) should be explored by officials.

7. But, whatever his officials may advise, Mr Ridley may still be attracted to reaching a fairly firm understanding with you before E(LA) meets on 22 June. Time constraints have increased the pressure on him to get a swift agreement. Mr Fellgett's brief sets out the line to take but the way towards such an understanding is summarised below. However, how far you feel able to go must depend upon Mr Ridley's stance at the meeting.

- i) The starting gap on AEG between Mr Ridley's lowest bid - option 3, fixed grant percentage (AEG = £13,920 million) - and your grant figure (AEG = £13,495 million) is £425m.
- ii) You might offer another £110 million on AEG - but only on the non-committal basis that this is for the purpose of exploring how far the gap between you and Mr Ridley might be bridged. This £110m could be seen as grant to cover Community Charge preparation costs.

- iii) You could indicate that your officials believe it should be possible to increase the allowance for special funds (see paragraph 4 of Mr Fellgett's brief) so as to reduce relevant expenditure and hence the amount of grant consistent with a fixed grant percentage by a further £150m.
- iv) There may be room for some further minor adjustments on financing items to reduce the gap by up to a further £25m.
- v) The outstanding gap would then only be £140m on grant. You might seek some gesture on grant from Mr Ridley indicating that, on that basis, you would then reluctantly accept option 3 on provision.

8. While paragraph 6 above describes the minimum objectives we should secure the most that might be gained would be an understanding, as follows. You would indicate that you might be prepared to accept, albeit reluctantly, a fixed grant percentage in 1989-90; but only if Mr Ridley will support option 3 on provision and agree that officials should find ways of reducing the amount of grant consistent with the fixed grant percentage by more than £150 million below the figures included in the tables. Should any such understanding be achieved, we will then need to consider how the E(LA) meeting should be handled. I think DOE officials are right to take the view that too obvious or too early a joint approach from you and Mr Ridley might lead service Ministers to dig in for a more generous settlement.

#### Fixed grant

9. Finally Mr Ridley may refer to another idea which has suddenly re-emerged - a fixed grant settlement. The basic idea is that grant would be paid on a notional amount of

expenditure set at 1988-89 budgets + X%, rather than actual expenditure. So there would be no underclaim of AEG at settlement, because grant would not be lost if an LA's budget exceeded the notional amount set.

10. The advantages are that it provides a way of closing down the RSG system and avoiding the scope for creative accounting for the last (and all preceding) years of the present system. Such creative accounting could be expensive to the Exchequer in terms of additional grant claimed. But the disadvantages are that we would lose all grant underclaim in 1989-90. The balance between the two in terms of Exchequer cost is unclear and we will need to do more work before being able to advise on the merits. (It is not even clear yet whether Mr Ridley himself will want to pursue fixed grant.) I would not therefore advocate that you raise the idea on Tuesday: but if Mr Ridley does so you could express interest without any commitment.

Barry H. Potter

BARRY H POTTER

Changes in Provision and Grant

<u>Provision Option</u>	<u>Grant Option</u>	<u>Increase in AEG</u>		
		<u>At Settlement*</u>	<u>At Outturn**</u>	<u>(AEG % at Outturn)</u>
1. £29350m : GDP+1 £1.6bn above PEWP	A £14148m : 44.7%	£1173m	£1536m	(44.0%)
	B £13495m : 42.6%	£520m	£887m	(41.9%)
2. £29100m : GDP £1.3b above PEWP	A £14036m : 44.7%	£1061m	£1295m	(43.6%)
	B £13495m : 43.0%	£520m	£760m	(41.9%)
3. £28840m : GDP-1 £1.1bn above PEWP	A £13920m : 44.7%	£945m	£1039m	(43.1%)
	B £13495m : 43.3%	£520m	£621m	(41.8%)
4. £28590m : GDP-2 £0.8bn above PEWP	A £13808m : 44.7%	£833m	£782m	(42.6%)
	B £13495m : 43.7%	£520m	£477m	(41.7%)

\* Change between AEG at 1988/89 settlement and AEG at 1989/90 settlement.

\*\* Change between AEG at budgets in 1988/89 and AEG payable for spending at 3% above Option 2 Settlement Expenditure Assumption.

Background 1988/89 settlement (adj for polytechnics)

Provision	£26836m
Budgets	£27866m
AEG at settlement	£12976m (42.7%)
AEG at budget	£12389m
Underclaim	£587m

## IMPLICATIONS OF OPTIONS FOR 1989/90 RATE SUPPORT GRANT SETTLEMENT

	Spending at Settlement Expenditure Assumption		Spending at 1.5% above Option 2 Settlement Expenditure Assumption		Spending at 3% above Option 2 Settlement Expenditure Assumption	
	(1)	(2)	(3)	(4)	(5)	(6)
<b>PROVISION OPTION 1 (£29,350m)</b>	<u>GRANT (A)</u>	<u>GRANT (B)</u>	<u>GRANT (A)</u>	<u>GRANT (B)</u>	<u>GRANT (A)</u>	<u>GRANT (B)</u>
AEG at Settlement:	£14,148m 44.7%	£13,495m 42.6%	£14,148m 44.7%	£13,495m 42.6%	£14,148m 44.7%	£13,495m 42.6%
AEG + rebates at Settlement:	49.1%	47.1%	49.1%	47.1%	49.1%	47.1%
Grant underclaim	-	-	-£34m *	-£35m *	£157m	£153m
Average rate increase:						
Non-rate limited	.3%	4.1%	1.5%	5.2%	4.9%	8.6%
All authorities	-.5%	3.0%	.6%	4.0%	3.6%	7.1%
CC at need (CCSN)	£216	£234	£216	£234	£216	£234
CC at spending level	£233	£251	£237	£255	£247	£265
<b>PROVISION OPTION 2 (£29,100m)</b>						
AEG at Settlement:	£14,036m 44.7%	£13,495m 43.0%	£14,036m 44.7%	£13,495m 43.0%	£14,036m 44.7%	£13,495m 43.0%
AEG + rebates at Settlement:	49.2%	47.4%	49.2%	47.4%	49.2%	47.4%
Grant underclaim	-	-	£91m	£88m	£287m	£280m
Average rate increase:						
Non-rate limited	-.6%	2.5%	2.8%	5.9%	6.2%	9.3%
All authorities	-1.2%	1.7%	1.8%	4.7%	4.9%	7.8%
CC at need (CCSN)	£212	£227	£212	£227	£212	£227
CC at spending level	£230	£244	£240	£255	£251	£265
<b>PROVISION OPTION 3 (£28,840m)</b>						
AEG at Settlement:	£13,920m 44.7%	£13,495m 43.3%	£13,920m 44.7%	£13,495m 43.3%	£13,920m 44.7%	£13,495m 43.3%
AEG + rebates at Settlement:	49.2%	47.8%	49.2%	47.8%	49.2%	47.8%
Grant underclaim	-	-	£223m	£219m	£427m	£420m
Average rate increase:						
Non-rate limited	-1.6%	.9%	4.2%	6.6%	7.6%	10.1%
All authorities	-2.0%	.3%	3.2%	5.4%	6.3%	8.5%
CC at need (CCSN)	£208	£220	£208	£220	£208	£220
CC at spending level	£226	£237	£243	£255	£254	£265
<b>PROVISION OPTION 4 (£28,590m)</b>						
AEG at Settlement:	£13,808m 44.7%	£13,495m 43.7%	£13,808m 44.7%	£13,495m 43.7%	£13,808m 44.7%	£13,495m 43.7%
AEG + rebates at Settlement:	49.2%	48.2%	49.2%	48.2%	49.2%	48.2%
Grant underclaim	-	-	£354m	£349m	£572m	£563m
Average rate increase:						
Non-rate limited	-2.5%	-.7%	5.5%	7.3%	9.1%	10.8%
All authorities	-2.7%	-1.1%	4.5%	6.1%	7.6%	9.3%
CC at need (CCSN)	£205	£213	£205	£213	£205	£213
CC at spending level	£222	£230	£246	£255	£257	£265

\* Grant overclaim

## OPTIONS FOR 1989/90 RATE SUPPORT GRANT SETTLEMENT

### NOTES TO TABLES

A. PROVISION: Option 1 is based on a 5% increase on 1988/89 budgeted current expenditure for non rate limited authorities plus current expenditure consistent with ELs for rate limited authorities and 1989/90 budget for Metropolitan Police. In options 2, 3 and 4 the increase for non rate limited authorities is 4%, 3% and 2% respectively. In all cases £110m has been added for the set up cost of community charge collection.

B. EXPENDITURE ASSUMPTION: Columns 1 and 2 of the table assume that authorities spend at the relevant settlement expenditure assumption described below. Columns 3 and 4 assume for all options that non-rate limited authorities spend at 1½% above the Option 2 Settlement expenditure assumption and rate limited authorities spend at EL. Columns 5 and 6 assume for all options that non-rate limited authorities spend at 3% above the Option 2 Settlement expenditure assumption and rate limited authorities spend at EL.

### SETTLEMENT EXPENDITURE ASSUMPTION

	<u>OPTION 1</u>	<u>OPTION 2</u>	<u>OPTION 3</u>	<u>OPTION 4</u>
Rate-Limited authorities	EL	EL	EL	EL
Metropolitan Police	assumed 1989/90 budget	assumed 1989/90 budget	assumed 1989/90 budget	assumed 1989/90 budget
Non-rate limited authorities	1988/89 budgets +5%	1988/89 budgets +4%	1988/89 budgets +3%	1988/89 budgets +2%
	+ community charge set up costs	+ c c set up costs	+ c c set up costs	+ c c set up costs

C. USE OF SPECIAL FUNDS AND BALANCES: The Settlement spending assumption assumes that special funds are reduced by £567m, as in 1988/89, and there is

no change in balances. At higher spending levels we assume that £900m of special funds are used to reduce total expenditure, but £430m is added to balances.

D. RATES: At all three spending levels, rate and precept limited authorities are assumed to levy a rate equal to their rate/precept limit.

Rate changes shown are for general rates: increases in domestic rates would be about 1% higher.

E. BLOCK GRANT MECHANISMS AND GRE: These are as in 1988/89 except that there is no cap on grant gains.

F. IMPLIED COMMUNITY CHARGE FOR SPENDING AT NEED is lower than community charge at settlement spending assumption because total GRE is lower than total provision.

G. SENSITIVITY TO GRANT: For every extra £100m of AEG rate increases would be about 1% lower than shown, for any given spending assumption.



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1. MR POTTER <sup>RHP 3/6</sup>
2. CHIEF SECRETARY

FROM: R FELLGETT

Date: 3 June 1988

cc: Chancellor  
 Sir P Middleton  
 Mr Anson  
 Mr Phillips  
 Mr A J C Edwards  
 Mr Turnbull  
 Mr Burns  
 Mr Call

## 1989-90 RSG SETTLEMENT FOR ENGLAND

You are meeting Mr Ridley on Tuesday 7 June. There is much to be said for reaching an understanding with him if possible. In E(LA) spending colleagues will press for high expenditure provision; Mr Hurd and Mr Moore have already put down markers. If Mr Ridley sticks to an unchanged grant percentage, that will drive up the quantum of grant, which really matters. On the other hand, I would not advocate an agreement with Mr Ridley at any price.

Line to take

2. I therefore recommend the following general line on the main items to be settled:

- Aggregate Exchequer Grant. The actual increase in grant being paid in 1988-89 is £500 million (4%). It would be a backward step to provide a bigger increase; that would simply fuel a higher increase in LA spending. Therefore support option B; an extra £520m to increase AEG in line with inflation. If pressed: accept option B £520m plus £110m to fund the full cost of Community Charge preparation.

- Expenditure provision. Bids submitted in Survey, including those by Mr Ridley himself, are very large. Nevertheless can be flexible about the options provided the higher options do not imply more grant. Colleagues may want option 1 or 2, and a bigger increase would deflect criticism that the plans were unrealistic. But options 3 or 4 would avoid the presentational difficulty of a large increase on the Survey baseline, and would keep up the grant percentage for any quantum of grant. Therefore prepared to argue for option 4 (£28,590m - an increase of £0.8bn) or option 3 (£29,840m - an increase of £1.1bn) if that would help Mr Ridley.
  
- Unallocated margin. Total of GREs is an important signal to LAs; it therefore should, as in 1987-88 and 1988-89, rise by no more than inflation (4%) plus adjustments for pay rises endorsed by the Government (teachers, police etc). Mr Ridley's proposed 8% increase in GREs would give completely the wrong signal that the Government believes LA spending needs have risen by twice the rate of inflation.

3. The key messages such a line should give Mr Ridley are:

- You will oppose most strongly any increase in the quantum of AEG much above option B. You are concerned about the likely actual increase at outturn, as well as the increase announced at settlement, because the outturn increase is the actual cost to the taxpayer and represents the actual financial pressure on LAs to control their spending.
  
- You are prepared to help Mr Ridley keep up the grant percentage, by holding down provision, notwithstanding the expenditure control and pay policy arguments against endorsing LA spending decisions through the signal of a broadly unchanged grant percentage.

- You will oppose a substantial increase in GREs because they are an important signal, but are not as concerned about this signal as about the actual financial pressure through AEG. (Indeed, I would not completely rule out Mr Ridley's GRE option, provided that secured a good firm agreement on AEG.)

4. We believe that it may be possible to square option B for AEG and option 3 for provision with a broadly unchanged grant percentage. This would involve squeezing the assumed level of those items of LA's relevant expenditure which are not classified as public expenditure, especially by making a realistic assumption about likely transfers from LA special funds to their general rate funds. Such transfers reduce relevant expenditure, although they are only book-keeping transactions, and LAs are likely to make full use of them to maximise their grant entitlement before April 1990, when such transfers will cease to affect grant. DOE officials must be aware of this possibility, but we have no hint about whether Mr Ridley would accept it.

5. I attach more detailed notes on:

- the key arguments;
- Mr Ridley's options and objections to them;
- various detailed or defensive points;
- an outline of a possible compromise.

6. Following your meeting, you will wish to consider further the terms in which you might write or speak to Mr Parkinson (a draft was attached to my submission of 7 April) and whether you want to write to E(LA) before the meeting on 22 June.

p.p. Barry H. Potter

R FELLGETT

## KEY POINTS

1. LA current spending remains the threat to our pledge to reduce government expenditure (central and local together) as a proportion of national income. Over the 3 years to 1988-89 LA current spending has increased by 29%, compared to inflation of 13% and 16% for public expenditure as a whole and growth in GDP of 26%.
2. Much of the problem is pay - with both management and union sides dominated by the Labour party - and manpower growth.
3. 1988-89 nevertheless a welcome improvement, with growth in spending cut back from 9½% in 1987-88 to 7½%. Firmer RSG settlement an important factor. At outturn (comparing grant actually paid in all years) increase in AEG reduced from £950m in 1987-88 to £500m in 1988-89; we gave them £450m less and that helped reduce the rate of increase in cash spending from 9.7% to 7.7% - a difference of £520m.
4. All this without big rates rises; up only from 6% in 1987-88 to 7½% in 1988-89, well below the 10½% that DOE forecast in July 1987.
5. Helpful signs on the pay front too. In 1987-88 LAs, buoyed by nearly £1 billion more grant, gave the manual workers 10½%. In 1988-89, with only a little over £½ billion more grant to spend, white collar workers have been offered just 4½%.
6. Therefore essential to stick closely to an increase in AEG in line with inflation, as it actually is in 1988-89. (Even that would be pretty generous compared to real cuts in AEG from 1979 to 1986.) Retrograde to fuel higher LA spending with more grant in 1989-90; must keep the trend in LA spending coming down ahead of the Community Charge.
7. Time to consider (no promises) more grant in 1990-91 when CC is introduced. Pointless to try and engineer popular low rate rises in 1989-90, just as the rates are about to be abolished.

MR RIDLEY'S OPTIONS

1. Option 2 for provision in 1989-90 means:

- an increase of  $4\frac{1}{2}\%$  compared to LA budgets, more than equivalent increase of 3.8% in 1988-89 settlement.
- claim on Reserve of £1.3 billion (5%), more than equivalent claim of £1.0 billion in 1988-89 settlement.
- increase of  $8\frac{1}{2}\%$  compared to provision made for 1988-89, more than equivalent increase of 7% in 1988-89 settlement.

Option 3 (but perhaps not option 4) should be defensible, notwithstanding acknowledged legal problem with any option that is too unrealistic.

2. AEG of £14,026m (an unchanged grant percentage of 44.7% with option 2 for provision) means

- an increase in grant at outturn of £1.3 billion on DOE's own figures, ie  $9\frac{1}{2}\%$  in cash and 5% in real terms.
- biggest percentage cash increase since 1980-81, when inflation was  $18\frac{1}{2}\%$ , and the biggest percentage real increase since before 1979.
- and in practice LAs would manipulate their special funds to increase grant by up to another £325m.

3. AEG of £13,920m (an unchanged grant percentage of 44.7% with option 3 for provision) means:

- an increase at outturn of £950m on DOE figures, ie  $7\frac{1}{2}\%$  in cash and  $3\frac{1}{2}\%$  in real terms.

- still biggest percentage cash increase since 1980-81 (apart from pre-Election 1987-88 settlement, which involved 8% rise), and still biggest percentage real increase in any year since before 1979.
- and in practice will be up to £325m higher.

4. Comparing a settlement based on Mr Ridley's option 2 and unchanged 44.7% grant percentage with actual LA budgeted spending and grant in 1988-89:

- grant goes up by £1,584m, to finance extra spending of £1,224m and leave rates to fall by 1.3%. This is because the grant percentage at outturn is actually increasing.

No one would believe that. If Mr Ridley really wanted to endorse £1.2bn of extra expenditure he should pay grant at 44.7% of £1.2bn, ie £540m more grant. His approach pays grant on £1.2bn and on the overspend in 1988-89.

5. Policy objections to an unchanged grant percentage are:

- undermines expenditure control policy. By paying grant at a fixed percentage of provision, based on LAs own budgeted spending in 1988-89, effectively finances half what they choose to spend one year in arrears. Allows LAs to dictate financing to the Government.
- undermines pay policy. Allows LAs to concede big pay rises and pass half the cost to the taxpayer, one year in arrears. Mr Ridley has often said that Government will not finance excessive pay rises; need to maintain credibility of such statements.

## DETAILED AND DEFENSIVE POINTS

1. Quantum of AEG has no effect on LA spending/lower increase in spending in 1988-89 entirely due to rate capping.

No. Rate capping important; Community Charge capping will be useful too. But non rate-capped LAs cut their increase in spending from 10.2% in 1987-88 to 9.0% in 1988-89. (DOE claim this is entirely due to lower price rises for LAs in 1988-89 - but that confirms our point, because prices (normally pay) are partly under LAs own control and lower pay rises are a response to greater financial pressure.)

2. Quantum of AEG affects only Conservative authorities, Labour just put rates up.

No. Tory and Labour authorities (apart from rate capped) both put spending up by 8% in 1988-89.

3. 7½% rates rises in 1988-89 too high - should have had more grant this year.

No. Nothing odd about 7½% rates rise for 7½% spending increase. But spending increase of 6% would have reduced rates rise to 4-5%.

4. DOE forecast rates rise for 1988 too high.

Yes. Figures from annex B to Lord Whitelaw's letter of 15 July 1987 compared to recent DOE rates monitor.

	DOE forecast	Actual
English average	10.4%	7.6%
Cambridgeshire	17%	4%
Gloucestershire	20%	12%

Fact is that LAs have reacted to lower increase in AEG in 1988-89 by moderating spending and rates.

5. Transition to Community Charge requires low rates rise in 1989-90/safety net means grant for 1990-91 fixed by 1989-90

No. Quite the opposite. No point in trying to make rates popular in their last year - Labour authorities would welcome that (Strathclyde have a rates freeze in 1988-89 in the last year before Community Charge in Scotland).

May be scope for greater increase in grant to ease safety net in 1990-91. No promises; consider it on its merits in 1989 E(LA).

6. New planning total (excluding LA self-financed expenditure) means LA spending no longer matters/claim on Reserve irrelevant.

No - objective remains that general government spending (including all LAs) should absorb a declining proportion of national income. Taxes raised by local authorities still part of the tax burden which Government is pledged to reduce.

Claim on Reserve exists under existing planning total and creates a presentational problem; just as valid as any presentational problem with the grant percentage, which will also disappear under new system from April 1990.

7. Government objective to maintain financing of 50% of LA spending, through AEG and rebates, into new system.

No - 50% simply roughly what happens now. "Objective" not even discussed collectively, let alone agreed.

Meaningless. 50% ratio depends, like the grant percentage, on definition of AEG (which will change in new system) and relevant expenditure (which is a creation of the 1980 Act, and will no longer exist in new system).



SQUARING OPTIONS 3 AND B WITH 44.7%

1. On the DOE grant percentage approach, AEG is 44.7% of an assumed level of relevant expenditure (ie provision for "relevant current" plus other items which are mostly not classified as public expenditure and do not therefore appear in the PEWP). Squaring therefore involves:

- a lowish provision for "relevant current";
- a low assumption for other items.

2. Within the other items, the main issue concerns special funds. LAs will, with minor exceptions, undoubtedly draw down before April 1990 all of the £1.9 billion special funds that they are believed to have on 1 April 1988. Up to 1990 each £100 million draw down will increase the grant paid to LAs by about £50 million; after 1990 there is no such incentive. They have budgeted for a draw down of £567 million in 1988-89, leaving a £1,333 million to be drawn in 1989-90. DOE initially assumed a draw down of £567 million again in 1989-90, but officials have already acknowledged that it could be £900 million.

3. It may not be realistic to assume that every £1 in special funds is withdrawn. A draw down in the range of £900 million-£1,250 million may be better. This could still be squared by either (or both):

- some reduction in the other items apart from special funds; and
- assuming a broadly unchanged grant percentage of, say, 44.5%. (The grant percentage at settlement did drop by 0.2% in 1988-89.)

The precise arithmetic can be a matter for DOE, consulting Treasury, provided that the answer is Option B for grant.

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CHIEF SECRETARY

FROM: B H POTTER

Date: 3 June 1988

cc: PS/Chancellor  
Sir P Middleton  
Mr Anson  
Mr Phillips  
Mr Edwards  
Mrs Case  
Miss Peirson  
Mr Turnbull  
Mr Fellgett  
Mr Call

**RATE LIMITATION 1989-90**

Although your discussion with the Secretary of State for the Environment next Tuesday will focus on the Rate Support Grant Settlement, he may also wish to cover rate capping. (The list of authorities selected for rate limitation in 1989-90 must be announced by end July.)

2. DOE officials have now confirmed that Mr Ridley will propose only seven authorities should be rate capped in 1989-90 under the selective provisions (c.f. seventeen in 1988-89). In addition, a number of Joint Boards, single purpose authorities formed after abolition of the metropolitan counties and the GLC and automatically selected up until 1988-89, are also likely to be rate-capped next year under the selective provisions. Specific proposals on these will be put forward by the Home Secretary and Secretaries of States for Education and Transport.

Line to take

3. Attached at annex A is a note on the recent history of rate-capping in England and at annex B a description of the options for 1989-90. I recommend the following line to take, if rate-capping is raised;

- too early to give any commitment; can only indicate a preliminary view;

- must certainly select for rate-capping all seven authorities proposed: but should not rule out going beyond this to include other authorities where spending is well above GRE;
- concern about large number of authorities which will escape rate-capping next year, not by reducing their underlying expenditure but by getting their total expenditure under the critical threshold by artificial means;
- points to the importance of ensuring that the Community Charge capping provisions are not fettered in a similar way, so that account can be taken of all sources of income to finance current expenditure when determining which authorities should be capped.

*Barry H. Potter*

BARRY H POTTER

## RATE-CAPPING SINCE 1985/86

1. Under the Rates Act 1984, the Secretary of State for Environment can select for rate limitation any local authority whose expenditure is excessive. Section 2 of the Act requires that excessive must be measured in terms of total expenditure (as defined in part VI of the 1980 Act). In practice, the criteria on total expenditure have referred to absolute levels of total expenditure above a threshold and year on year growth in total expenditure. Each authority selected is given a maximum Expenditure Level (again defined in terms of total expenditure) to which the rate-cap is linked.

2. Very broadly the picture over the first three years was of rate-capped local authorities getting around their Expenditure Levels, by a combination of creative accounting measures:

- the use of accumulated reserves and balances (which made the largest contribution);
- reclassification of revenue spending as capital (housing repairs but also other expenditure) mainly paid for by capital receipts; and
- sale and leaseback and other creative financing devices.

So actual current expenditure exceeded the current spending set at Expenditure Level.


3. Indeed a distinction needs to be drawn between the total expenditure of rate-capped authorities as formally defined and underlying actual current expenditure. Thus the 17 authorities selected for rate limitation this year had budgets in 1987-88 which showed total expenditure at levels between 15 and 30% above GRE, over a selection threshold of GRE + 12½%. But their underlying expenditure ie total expenditure plus other current expenditure financed from non-rate sources was even greater - in the range of some 30-50% above GREs.

Up to 1987-88, creative accounting allowed most authorities to sustain their underlying spending. But in 1988-89 there have been two interesting developments. First we agree with DOE's view that there is now real evidence that some authorities are cutting back on their expenditure. In 1988-89 rate capped authorities budgets showed a cash increase of just 1.7%; non rate-capped authorities increased budgets by 9.0%. But it is not only their total expenditure but also underlying spending which is being curtailed. For example, material gathered by the monitoring group suggests underlying spending has been cut by £4 million in cash terms this year in Tower Hamlets, by £3.5m in Camden; and held constant in Manchester. Elsewhere the rate of growth has generally been reduced - although in one or two authorities like Brent it continues to escalate alarmingly.

5. Secondly, however, authorities have become much more skilful at playing the rate-capping game. Following various legal cases, local councils have a fairly astute idea of the constraints on DOE in setting its selection criteria (see legal advice at attachment A). The most important criterion is the threshold on absolute spending, ie only those with higher total spending can be selected. This has been set at GRE + 12½% for several years. Counsel advised again only yesterday (2 June) that this criterion cannot safely be tightened further. And, although we have narrowed the scope for creative accounting, there remains sufficient flexibility for many councils to get budgeted total expenditure under the critical GRE + 12½% threshold and thus escapes the ratecapping net - while underlying expenditure remains much higher.

6. As you are aware we are taking steps to tighten the regime under Community Charge capping which takes over in the year after next:

- i) the system will operate in-year; so the criteria can be set after we have local authorities' budgets not on the basis of the preceding years' budget;
- ii) we are seeking to ensure that the proposals allow DOE to take into account all sources of local authority



finance, ie including the likely use of creative accounting. We are still pressing Parliamentary Counsel to amend the Local Government Finance Bill to ensure this is allowable - even though Counsel's advice is that the present clauses are sufficient to do this.

## RATE CAPPING IN 1989-90

For next year Mr Ridley is proposing to continue with a two category approach:

- a) for local authorities previously selected, there will be a single selection criterion - total expenditure in excess of GRE + 12½%;
- b) for those not previously selected, the criteria will be total expenditure of GRE + 12½% and a 6% year on year increase in total expenditure.

2. All seven of those proposed for rate capping come under the first category (see table B). And all but one of the other ten authorities rate capped this year have escaped by getting their total expenditure under the critical GRE + 12½% threshold. (The other one - Basildon - escapes essentially on a de minimis expenditure point). However many of these ten are still spending in underlying expenditure terms well over their GREs. Moreover, even if the legal advice had allowed a tighter limit down to the theoretical maximum of GRE + 10% (ie the point at which the slope of the grant schedule becomes steeper) we would only capture one further authority - Middlesborough - and even then only just.

3. There is possible scope to select authorities next year not previously selected in 1988-89. If we were to adopt only the a) criterion rather than b) for new candidates, a further four authorities would come within the net - the City of London, Blackburn, Bristol and Leicester. While we could propose that only the single criterion would apply, we cannot select the other three authorities without also including the City. And quite apart from any other considerations, the special nature of the City is thought to mean that its GRE is not a fair measure of its assessed need to spend. Again we might face legal challenge.

4. In practice, given the legal advice, the choice lies between the 7 authorities proposed by Mr Ridley or taking in the extra 4 identified in paragraph 3. The position is unsatisfactory: but it would not be possible to persuade Mr Ridley to take the legislative action necessary to capture any of the authorities escaping this year. It does highlight the need for the Community Charge capping power not to be restricted in this way.



Extract from legal Advice to DOE.

- a) a single "GRE-only" criterion for previously selected authorities should be satisfactory, but it is important that the Secretary of State has reasoned arguments (eg, effects of previous rate limitation on authorities' present total expenditure) for so determining;
- b) fixing the criterion at "12% over GRE" should be satisfactory: this was primarily a matter for the Secretary of State's judgement and, notwithstanding the existence of an unallocated margin, it was hard to envisage a successful challenge being mounted;
- c) going below 12% down towards 10% would be much riskier, and it would be absolutely essential to have a reasoned basis for such a determination which fully thought through such factors as the approximation of GRE's and the justification for the 10% threshold nationally;
- d) "threshold" is not really a starter if it would mean selecting authorities below the average threshold level (GRE + 10%). The Secretary of State would have to be satisfied that the mechanisms producing individual thresholds were not imperfect or unfair in themselves, and that the effects of such a selection criterion would not produce unreasonable designations of individual authorities (eg, when compared with their GRE);

## SELECTION OF AUTHORITIES FOR RATE LIMITATION 1989-90

	OVERSPEND ON GRE %	SPENDING GROWTH 1987-88 TO 1988-89
A. re-selected authorities		
THAMESDOWN	69.0	3.6
GREENWICH	39.6	1.6
CAMDEN	29.7	-3.3
LEWISHAM	29.2	-1.6
TOWER HAMLETS	23.1	2.5
HACKNEY	19.7	-10.2
SOUTH-WARK	13.1	-10.2
B. authorities not reselected		
BASILDON	62.8	-25.9
MIDDLESBROUGH	10.7	-1.7
KINGSTON-UPON-HULL	9.4	-16.0
NEWCASTLE-UPON-TYNE	9.2	1.7
LAMBETH	8.9	-0.1
MANCHESTER	8.5	0
LIVERPOOL	8.3	-1.7
WALTHAM FOREST	3.3	-7.0
HARINGEY	3.2	-0.1
EALING	3.2	1.1
C. authorities not selected but spending more than 12.5% over GRE		
CITY OF LONDON	97.3	2.7
BLACKBURN	25.2	-3.4
BRISTOL	23.3	2.7
LEICESTER	17.9	-18.2

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FROM: JILL RUTTER

DATE: 7 June 1988

22nd afternoon  
29th afternoon  
31st July

Ry

MR POTTER

CC:  
PS/Chancellor  
Sir Peter Middleton  
Mr Anson  
Mr H Phillips  
Mrs Case  
Mr Edwards  
Miss Peirson  
Mr Turnbull  
Mr Fellgett  
Mr Call

**MEETING WITH SECRETARY OF STATE FOR ENVIRONMENT: DISCUSSION  
ON 1989-90 RSG SETTLEMENT**

The Chief Secretary de-briefed Mr Fellgett and Mr Edwards about the outcome of his meeting with Messrs Ridley and Howard.

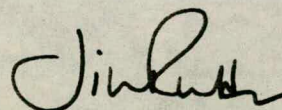
2 The Chief Secretary had a long and good natured discussion with Messrs Ridley and Howard. He said, however, it revealed a fundamental disagreement about the approach to next year's Rate Support Grant settlement. Department of Environment Ministers saw the 1989-90 settlements as a platform for the introduction for the Community Charge - they did not want a very tight settlement because they did not want shire counties running down their balances in 1989-90 to avoid rate increases. They were concerned that authorities would build up their balances again the following year and impose higher community charges and blame the Government. Mr Ridley also expressed his concern about the level of service provision - in particular for DHSS - and said that he wished to hear the arguments of the spending ministers before making up his mind on provision. He also questioned the Chief Secretary's assertion that DOE's rates forecasts had been excessively high last year.

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3 For a conventional settlement, Mr Ridley revealed himself utterly rigid on maintaining the grant percentage at 44.7 per cent. He said that his bottom line on provision was option (ii) £29.1 billion with an associated AEG at settlement of £14.036 billion. He made it very clear that he was unshiftable opposed to option (b) on grant.

4 The Chief Secretary reported that at the start of the meeting Mr Ridley raised the question of fixed grant and clearly saw considerable advantages in closing down the RSG system in the way set out in your minute. It was agreed that the Treasury and DOE officials should do urgent work on a fixed grant settlement. The Chief Secretary told Mr Ridley that he assumed that this would mean a lower grant settlement since there would be no grant underclaim. Mr Ridley apparently rebutted this by saying that under a conventional settlement there was a risk of a grant overclaim in 1989-90. This work is not to be mentioned outside Treasury and DOE and, if no agreement has been reached before the first E(LA), it would not be mentioned there. From Mr Ridley's presentation of the fixed grant settlement it seems implicit that he accepts that it would not make sense to talk in terms of maintaining the grant percentage at 44.7 per cent - though Mr Ridley did not explicitly make this point at the meeting.

5 The Chief Secretary would be grateful if LG could take the necessary work forward. He does not intend to write to Mr Parkinson at this stage. He would welcome a report back in the next week on progress made with DOE officials.



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JILL RUTTER  
PRIVATE SECRETARY



FROM: A C S ALLAN  
DATE: 7 June 1988

*psp*

*BE13/16*

*psp*

PS/CHIEF SECRETARY

cc Sir P Middleton  
Mr Anson  
Mr Phillips  
Mr Turnbull  
Mr A J C Edwards  
Mr Potter  
Mr Fellgett

**1989-90 RSG SETTLEMENT**

The Chancellor was grateful for Mr Fellgett's note of 27 May on the links between the 1989-90 and 1990-91 settlements, and about when we might acknowledge that the safety net in 1990-91 could be more generous than an increase in grant at outturn in line with inflation would imply.

2. The Chancellor would delay any acknowledgement, if possible until next year, and certainly until it is clearly needed this year - ie. if arguments about the level of the community charge next year become a major feature of E(LA) discussions this year.

*ACSA*

A C S ALLAN

9/6/88.

PP



CH/EXCHEQUER	
REC.	09 JUN 1988
ACTION	CST
COPIES TO	

9/6

Prime Minister

LOCAL AUTHORITY CAPITAL EXPENDITURE AND FINANCE

At E(LF)(88)4th meeting, I was invited to bring forward a draft consultation document covering the control of capital expenditure on both housing and other local authority services.

Such a draft is now attached. Whilst it has substantially the same structure as the version annexed to my minute of 15 March, it covers both housing and other services and endeavours to take account of the helpful points which colleagues made at the E(LF) discussion. I would draw attention to the following points:-

- a. The main features of the new system proposed are set out in the foreword. It is primarily a control on the use of credit to finance capital expenditure. By credit is meant not merely borrowing but also deferred purchase and lease/leaseback, which have the same economic effect. Local authorities will have to set aside a proportion of their capital receipts for debt redemption or investment, but otherwise may make free use of revenue contributions and capital receipts.
- b. The proposals for capital expenditure on council housing are very similar indeed to those on other services. The main difference is that a greater proportion of housing receipts will have to be applied to debt redemption and that (to preserve the principle of ring-fencing housing expenditure) any revenue contributions to housing capital expenditure must come from the housing revenue account.
- c. The question of the compatibility of the proposals with past assurances on the use of capital receipts is dealt with (in paragraph 28) by comparing the present proposals with those made in 1986 (which was very shortly after the



assurances were given). The 1986 proposals were not criticised on the grounds of incompatibility and thus the present (less restrictive) proposals should not attract this criticism.

- d. The draft includes (in paragraph 30) a reference to the scheme for the voluntary transfer of spending power from housing authorities to other authorities providing services in the same area, which we are discussing. I do not think we need to go into greater detail about this scheme at this stage, but I propose the paragraph should stand unless colleagues see any difficulties.

The technical annex is being cleared by officials.

The main proposals, namely that controls should in future primarily apply to the use by local authorities of credit to finance capital expenditure and that they should be free, though subject to the discipline of the community charge, to finance capital expenditure from revenue contributions, will be welcomed, and not least by our supporters in local government. Indeed, the proposals are in many respects rather similar to those that I would expect to find favour with the Association of District Councils.

There are pressing reasons for issuing the consultation paper as soon as possible. We need a new capital control system to replace the existing ramshackle provisions which we are constantly having to amend. If the new system is to come into effect from 1 April 1990 along with the community charge, then we need to legislate next Session and to have gone through the consultative processes before then. If you and colleagues are content with the present draft, then I would aim to publish later this month. To achieve this, it would be helpful to have clearance by Thursday 16 June.



I am minuting separately on the question which we discussed at E(LF) about the use of in-year receipts.

/ I am sending copies of this minute to the other members of E(LF) and to Sir Robin Butler.

A handwritten signature, likely of the Secretary of State, consisting of stylized initials.

N R

9 June 1988



DRAFT OF 9 JUNE 1988

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LOCAL GOVERNMENT IN ENGLAND AND WALES

CAPITAL EXPENDITURE AND FINANCE

A CONSULTATION PAPER

DEPARTMENT OF THE ENVIRONMENT

WELSH OFFICE

[DATE]

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FOREWORD

This consultation paper is about capital investment by local authorities and the means by which they pay for that investment. This year, councils in England and Wales will spend about £6 billion on home improvements and new house-building, on new roads, schools, health centres, and other buildings, on vehicles, computers, and other plant and machinery, and on derelict land reclamation and urban renewal. They will raise about £2.8 billion by selling houses and other property; the remainder will be paid for by borrowing, or from Government grants, or from revenue.

Over the years, councils have built up a very large stock of capital assets. Much of this was paid for out of borrowed money. Their borrowings are now about £45 billion, which is roughly 25% of the total national debt. Debt charges, which fall to ratepayers and tenants, amount to £6 billion a year.

Local authority capital expenditure and finance is a major component of the national economy. It has to be regulated as part of the Government's task of managing the economy as a whole.

During the 1980s, our control system has focussed on the capital spending itself. But the system has been unsatisfactory for both central and local government. Everyone agrees that we need a change.

The reform of local government finance from 1990-91, and in particular the accountability which will be brought about by the community charge, gives us the opportunity to make a radical change. This consultation paper proposes a switch from controlling capital spending as such to controlling the money used to finance it. The main sources of finance for capital spending, and the way they would be treated under these proposals are:-

- \* Borrowing. Money raised through borrowing and other forms of credit would be controlled within annual limits set by Central Government. This is necessary because of the impact of such borrowing on the

Public Sector Borrowing Requirement and the national economy, and in order to control the extent to which some local authorities have sought to spend now and pay later. We propose that authorities should receive provisional credit limits up to three years in advance.

- \* Government grants. The Government would continue to pay grants towards some capital expenditure.
- \* Revenue contributions. Local authorities would be free to pay for capital spending from revenue. They could thus balance the benefits of capital and revenue spending against each other, though in each case subject to the accountability of the community charge.
- \* Capital receipts. Between 1981-82 and 1987-88, local authorities raised about £17 billion by the sale of capital assets. Of this, £12.5 billion were housing receipts and £4.5 billion came from the sale of other property. Of the £17 billion, about £11 billion has been spent, either on new capital investment and on the repair and modernisation of property (about £6½ billion) or on the redemption of debt (about £4½ billion). But at the end of the last financial year, local authorities still had £4.4 billion of unused housing receipts and £1.8 billion of other unused receipts. We expect authorities to continue to realise receipts at a rate of about £1.9 billion a year from council house sales and about £1 billion a year from other sources. And, within the last year, it has become apparent that there are real prospects of the transfer en bloc to new landlords of whole council estates or even of the whole stock of individual local housing authorities. The benefits of the success of local authorities in realising receipts should be returned to the residents of the areas concerned, either by way of new capital investment or by way of a reduction in debt interest falling to be met from the community charge. The paper proposes a framework within which part of the cash from existing and future receipts will be used for the repayment of debt or as a substitute for future borrowing and part will be available for capital expenditure which will benefit the areas of the local authorities concerned.

These proposals will provide the Government with control over the effect of local authorities' capital programmes on the public sector borrowing requirement. They will also provide a sound basis for local authorities to

plan their capital programmes, in particular through the provisional credit limits for future years and the flexibility provided by the free use of revenue contributions and a proportion of capital receipts.

NICHOLAS RIDLEY  
Secretary of State  
for the Environment

PETER WALKER  
Secretary of State  
for Wales

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## INTRODUCTION

### Purpose and scope of consultation paper

This consultation paper invites comments on the Government's proposals for the reform of the legislation which regulates the capital expenditure and finance of local authorities in England and Wales. In very broad terms, the existing system of controls on the amount of capital expenditure by local authorities and on the use that they can make of capital receipts (referred to in this paper as the "1980 system") and the existing system regulating borrowing by local authorities (referred to as the "1972 system") would be replaced by a system (referred to as the "new system") which would control the amount of new credit obtained by local authorities and which would incorporate requirements for a proportion of capital receipts to be applied to the redemption of debt or to be set aside to meet future commitments. The new system would take effect from the beginning of the financial year 1990-91, in parallel with the new system of local authority current finance in the Local Government Finance Bill now before Parliament.

The paper first describes the circumstances which led to these proposals and the defects that have become apparent in the legislation as it now stands. It then describes the objectives which the Government is seeking to achieve, and provides a broad outline of the new system and how it will meet those objectives.

The Annex to the paper describes the new system in detail and, in particular, indicates:-

- a. the local authorities to which it will apply;
- b. the definition of capital expenditure that will be adopted;
- c. the methods which will regulate local authority capital expenditure financed by credit;
- d. the other sources of finance (including revenue contributions and part of their receipts from sale of assets) that authorities will be able to use to finance capital expenditure;

- e. the provisions for investment by local authorities of temporarily surplus funds;
- f. the regime which will apply to borrowing by local authorities from external sources; and
- g. the transitional arrangements proposed.

In this consultation paper, references to "the Secretary of State" are references to the Secretary of State for the Environment in the application of the new system to England and to the Secretary of State for Wales in its application to Wales. References to "Departmental Ministers" are references to the Ministers with policy responsibility for particular services on which local authorities incur capital expenditure, including not only the Secretaries of State for the Environment and for Wales but also the Secretaries of State for Transport, Social Services, Education and Science, and the Home Department, the Minister of Agriculture, Fisheries and Food, and certain others. The Glossary summarises the abbreviations and other special terminology used.

The White Paper "Housing: The Government's Proposals" (Cm 214) stated that the Government would be bringing forward proposals for a new financial regime for council housing which would reinforce the present statutory distinction between the provision of housing and other local authority functions. This paper sets out the special provisions which it is proposed that the new regime should include in relation to capital expenditure by local authorities on housing of which they are or will be the landlords and capital receipts from the disposal of such housing. It does not deal with the revenue aspects of the new housing finance regime. The new system will apply to capital expenditure in connection with other local authority housing functions, including home improvement, renovation, and insulation grants, slum clearance and area improvement, assistance to owners of defective housing, mortgage lending to private persons (other than to those purchasing council houses), and development loans to housing associations, in the same way as it applies to non-housing services.

This consultation paper does not deal with the question of capital expenditure and borrowing undertaken by companies which are controlled or influenced by local authorities. A separate consultation paper has been issued covering all aspects of local authority companies.

#### Submission of responses to consultation paper

Comments on the general principles of the proposals and on their implications for capital programmes of English local authorities should be sent to:-

Department of the Environment  
Finance Local Capital  
Room N9/04  
2 Marsham Street  
LONDON SW1P 3EB

Comments on the general principles of the proposals and on their implications for capital programmes of Welsh local authorities should be sent to:-

Welsh Office  
FL1 Division  
Room 2-001  
Cathays Park  
CARDIFF CF1 3NQ

Comments should be submitted not later than 30 September 1988. It would be helpful if, when sending comments to either Department, respondents would say whether copies have also been sent to the other.

Availability of further copies

Further copies of this consultation paper can be obtained from the addresses above, telephone 01-276 3042 (England) and 0222-825307 or 825668 (Wales).

Public release of responses to consultation paper

Those who respond to this consultation paper are asked to indicate whether they propose to publish their responses, or to make them available to the media, and whether they would be content for the Departments to make their responses available to Parliament and to the public by placing copies in the Libraries of both Houses of Parliament and in the Departments' libraries. Respondents who wish their responses to be made available are asked to provide four extra copies for this purpose. (Otherwise, the Departments do not undertake that responses will be released.) Unless respondents indicate that they wish their responses to be made available, the Departments will assume that they wish them to be treated as having been given in confidence. Summaries of views received which are published but which do not identify the views of individual respondents, may, however, incorporate such responses.

## LOCAL AUTHORITY CAPITAL EXPENDITURE AND FINANCE

### Background

1. Capital expenditure by local authorities accounts for about 40% of all civil capital expenditure by the public sector. In England and Wales, it is about £6 billion a year, that is £170 per adult. It covers the purchase, construction, renovation and improvement of buildings and roads; the purchase of land, vehicles, plant and equipment; and the making of grants and loans to other people and bodies for capital purposes.

2. Local authorities have traditionally financed most of their capital expenditure by borrowing. But Table 1 shows how the capital receipts generated by local authorities have grown during the 1980s.

TABLE 1 LOCAL AUTHORITY CAPITAL EXPENDITURE AND RECEIPTS  
ENGLAND AND WALES (£m)

	Gross expenditure	Receipts	Net expenditure
1981/82	4078	1348	2730
1982/83	5214	2174	3040
1983/84	6046	2244	3802
1984/85	6248	2257	3991
1985/86	5707	2276	3432
1986/87 (provisional)	5669	2752	2918
1987/88 (forecast)	6088	3259	2829

Some of these receipts have been used to repay debt or have been held as balances. But Table 2 shows how capital receipts have come to finance an increasing proportion of gross capital expenditure.

TABLE 2 FINANCING OF LOCAL AUTHORITY CAPITAL EXPENDITURE  
ENGLAND AND WALES

	1981/82	1985/86
% (rounded) of expenditure financed by:-		
Borrowing (including advances from capital funds)	70	57
Capital receipts	7	25
Government grants	12	7
Revenue contributions (including transfers from special funds)	9	7
Leasing	2	5

3. Because of the extent to which local authorities borrow for capital expenditure, the Local Authority Borrowing Requirement (LABR) has always been an important element of the Public Sector Borrowing Requirement (PSBR), accounting for more than a quarter of it in some years. Notwithstanding the importance of capital receipts as a source of finance, borrowings by local authorities in England and Wales from banks, the Public Works Loan Board, and other sources had grown to £45 billion by the end of 1986/87. The cost of servicing that debt amounts to about £170 a year for each adult.

4. Controls on borrowing and capital expenditure by local authorities have been exercised by Central Government ever since local authorities in their modern form were constituted in the last century. The reasons for these controls include the need to manage the national economy in view of the effect on public spending and the PSBR discussed above; to ensure that investment by local authorities responds to national priorities; to maintain accountability, since the financial effect of expenditure financed by borrowing is felt only to a very limited extent when it is incurred; to safeguard the interests of future local tax payers; and to maintain the high credit standing which local authorities generally still enjoy.

5. Since local government reorganisation in 1974, the control on borrowing has been operated under the Local Government Act 1972. But, during the later 1970s, it became clear that the 1972 system alone offered the Government of the day too little influence over either capital expenditure or the LABR.

6. The Local Government, Planning and Land Act 1980 introduced, beginning with the financial year 1981-82, the present system of controls on capital expenditure and the use of capital receipts by local authorities.

#### The problems of the 1980 system

7. The 1980 system has suffered from four major problems.

8. First, it has failed to bring about net capital expenditure consistent with the Government's public expenditure plans. Table 3 shows outturn since 1981/82 against the DOE/LA1 and WO/LA1 cash limits, which cover most capital expenditure and receipts in England and Wales.

TABLE 3 OUTTURN AGAINST DOE/LA1 AND WO/LA1 CASH LIMITS

DOE/LA1	Cash limit	Outturn	Overspend (+)/ Underspend (-)	
	£m (net)	£m (net)	£m	%
1981/82	3139	2610	-529	-17
1982/83	3385	2515	-870	-26
1983/84	2935	3350	+415	+14
1984/85	2453	3525	+1072	+44
1985/86	1911	2908	+997	+52
1986/87 (provisional)	2369	2387	+18	+1
1987/88 (forecast)	2834	2070	-764	-27

WO/LA1 (LA element)	Cash limit	Outturn	Overspend (+)/ Underspend (-)	
	£m (net)	£m (net)	£m	%
1981/82	220	173	-47	-21
1982/83	275	249	-26	-9
1983/84	305	315	+10	+3
1984/85	237	256	+19	+8
1985/86	249	266	+17	+7
1986/87	268	323	+55	+21
1987/88 (forecast)	298	350	+52	+17

The cash limit applies to the difference between gross expenditure and capital receipts in any year. Many of the problems have stemmed from the difficulty of forecasting receipts during a period in which they have been growing significantly. But gross expenditure has in most years been higher than had been assumed when the cash limit was set; these overspends have been as much as 44% of the planned gross expenditure.

9. Secondly, the 1980 system has brought about a distribution of capital spending power which does not match the need for expenditure. The amount of capital expenditure which it permits each local authority to incur in any year is determined as the sum of several components. The two main components are the capital allocations issued to the authority by Departmental Ministers and a proportion of the unused capital receipts which the authority have generated both in the year concerned and in previous years. But the 1980 system does not permit the Government to take account when issuing allocations to individual authorities of the ability of those authorities to finance expenditure from receipts. So the Government cannot distribute allocations so as to "top up" spending power from receipts and thus to produce a distribution of total spending power which matches the need to spend. Table 4 shows how the distribution of allocations between classes of authority, which reflects the Government's assessment of need, differs from the distribution of total spending power.



TABLE 4 PERCENTAGE BREAKDOWN OF SPENDING POWER BETWEEN CLASSES OF AUTHORITY 1987/88  
(% rounded)

	Allocations	Total Spending Power
DOE/LA1		
Shire Counties	22	14
Shire Districts	27	40
Metropolitan Areas	28	22
Inner London and City	12	12
Outer London	11	12
WO/LA1		
Counties	41	32
Districts	59	68

10. This problem has been exacerbated by what is known as the "cascade". It had been the intention of the 1980 system that only a proportion ("the prescribed proportion") of receipts would be available to justify new expenditure and that the remainder would be applied to debt redemption. But it has since been accepted that the Local Government, Planning and Land Act 1980 permits the prescribed proportion of receipts to be used to justify prescribed expenditure in the year of receipt, the prescribed proportion of the unused balance in the next year, and so on. Authorities can thus use all their receipts over time although the rate at which they may use them is restricted. Under the "cascade", large amounts of receipts have accumulated and the nominal value of such receipts now exceeds £10 billion. About 40% of these receipts are notional in the sense that the cash has been spent on other things (such as repaying debt) and is thus not available to finance new capital expenditure. Nevertheless, spending power from receipts has grown to over £3½ billion per year and is now greater than the rate at which new receipts are being realised. For any given level of planned local authority expenditure, higher spending power from receipts leaves less room for allocations and consequently reduces the Government's ability to target resources on areas of need. Table 5 shows how receipts in England have grown as a proportion of total spending power in recent years.

TABLE 5 SPENDING POWER ON DOE/LA1 CASH LIMIT

DOE/LA1	1985/86	1986/87	1987/88 (forecast)	1988/89 (plan)
	£m	£m	£m	£m
Spending power from:-				
Allocations	3045	2755	2639	2626
Receipts	2313	2779	3298	3583
Other	<u>344</u>	<u>314</u>	<u>304</u>	<u>302</u>
Total spending power	5702	5848	6241	6511
of which receipts are:-	41%	48%	53%	55%

11. Thirdly, the legislation governing the 1980 system has not prevented local authorities from undertaking capital expenditure outside the framework laid down by the legislation. Amending legislation, including the measures relating to leasing and barter in the Local Government Finance Bill now before Parliament, has closed the most widely exploited loopholes.

12. Fourthly, because the problems outlined above have led to frequent changes in the primary and secondary legislation and in the other factors governing the system, the 1980 system has not provided a stable framework within which long term capital programmes can be efficiently administered.

#### The "Paying for Local Government" Proposals

13. The Government and local authorities have long recognised the deficiencies of the 1980 system. Following a joint review in 1985, the Government put forward in the Green Paper "Paying for Local Government" (Cmnd 9714) two possible new systems:-

(i) a control over all external borrowing by local authorities for revenue and capital purposes, through annual external borrowing limits (EBLs); or

(ii) a control over gross capital expenditure.

14. The Government was attracted in principle to an EBL system, but had doubts about whether it could be made to work in practice. It therefore saw the gross expenditure option as the more likely solution and issued a consultation paper setting out the details of such a system.

15. The responses to that consultation paper confirmed the Government's doubts about the practicability of EBLs but also showed that a system based on control of gross expenditure would not command general support. The Government considered that any new system should offer improvements for both central and local government and decided to reconsider the control of capital expenditure alongside the proposals for the wider reform of local government finance set out in "Paying for Local Government". The Government also wished

to consider the recommendations of the Public Accounts Committee in their report on the "Control of Local Authorities Capital Expenditure" (HC 444, Session 1985-86).

### The Government's Objectives and Proposals

16. The Government's objectives for a new system to regulate local authority capital finance remain broadly the same as those set out in "Paying for Local Government":-

- \* To provide effective Government influence over aggregate levels of local authority capital expenditure and borrowing.
- \* To bring about a distribution of capital expenditure, both as between areas and between services, which reflects both national and local needs.
- \* To promote the Government's aim of reducing the size of the public sector by asset sales and efficient asset management.
- \* To provide a sound basis for local authorities to plan their capital programmes with confidence.

17. The Government remains committed to the firm control of public expenditure and borrowing. But the community charge will reduce the need for direct controls on total capital expenditure. All expenditure financed from revenue, whether for current or capital purposes, will be subject to the discipline imposed by the accountability inherent in the community charge. The new system proposed in this consultation paper is therefore primarily a control on the use of credit by local authorities to finance capital expenditure. Its secondary purposes are to secure that local authorities make prudent provision for the repayment of debt both during the periods for which assets are held and when they are sold and that there is, in time, a reduction in the overall level of local authority indebtedness.

### Outline of the new system

18. The new system will provide a framework for all financial commitments of a capital nature entered into by local authorities. The main classes of such commitments are:-

- (i) the acquisition of rights to use (other than on a temporary basis) land, buildings, plant, machinery, vehicles, and other tangible fixed assets;
- (ii) the construction of buildings, roads, and other structures, and the carrying out of improvements to land, buildings, or other property used by local authorities or of works which enhance the value of the property or lengthen its useful life;

- (iii) the making of grants or loans in support of capital expenditure undertaken by other persons; and
- (iv) the making of investments (other than the temporary deposit or placement of surplus funds).

19. When a local authority wish to acquire the use of assets, or to improve or to have works done to assets which they use, they may pay immediately and in full for the assets or works. They may, however, make arrangements under which the immediate costs are met, or the assets are provided, by some other person to whom they make payments over a period of time or at some later date. In economic terms, the effect of such arrangements is as if the authority had met the costs outright and had borrowed the necessary sums from the other person concerned. The new system will treat such arrangements, which in this consultation paper are called "credit arrangements", like borrowing.

20. Under the new system, there will be three sources of finance for capital commitments:-

- (a) borrowing or credit arrangements;
- (b) Government grants or contributions from third parties (including other local authorities), whether in the public or the private sector; and
- (c) local authorities' own resources (including revenue contributions and cash realised from disposals of assets to the extent that it is not used to redeem debt or set aside to meet future commitments).

21. The Government will place limits on the level of commitments which individual local authorities may enter into in any year and finance by borrowing or credit arrangements. Before the beginning of each financial year, each authority will be told the amount of their basic credit approval for that year. That amount will have been calculated in light of the Government's assessment of the appropriate shares for the authority of the provisions in public expenditure plans for the services administered by the authority. To assist forward planning, each authority will at the same time be given an indication of levels below which their basic credit approvals for the next two financial year will not be reduced. Basic credit approvals may be enhanced by supplementary credit approvals covering particular projects or programmes.

22. Local authorities will additionally be able to undertake capital expenditure which is to be paid for from Government grants or from contributions from other sources (including other local authorities).

23. Local authorities will also be free to use revenue contributions to finance additional capital expenditure, though such contributions will have to have been provided from the appropriate service account. In particular, any revenue contributions by a local authority to capital expenditure on their own housing will have had to have come from their housing revenue account. Revenue contributions may be used immediately or carried forward to future years.

24. The total capital borrowings of local authorities in England and Wales were £34 billion in April 1981, when the 1980 system came into effect, and now amount to about £45 billion. The Government considers that proper provision should be made for the repayment of local authority debt and that reductions in the direct provision of services (for instance housing) by local authorities should be accompanied by an appropriate reduction in indebtedness. The new system will provide that:-

- (a) insofar as capital expenditure under the new system is financed by credit, authorities will be required to make charges to revenue account sufficient not merely to cover interest but also to repay the principal by equal instalments over appropriate periods; and
- (b) part of the proceeds of disposal of fixed assets must be applied to debt redemption or be set aside to meet future capital commitments which would otherwise have to be met by borrowing or reborrowing.

These provisions will correct two unsatisfactory features of the present legislation, namely that amortisation of principal is required, but that the rate at which this must be done is not specified and that the proceeds of property disposals must be applied either to debt redemption or to other capital purposes, but there is no requirement that any definite part should be applied to the former purpose. Most authorities already provide for debt redemption. The new system will require all to do so at a prudent rate.

25. Local authorities will be able to use part of the cash proceeds of disposal of fixed assets for capital investment. The Departments consider that initially up to 25% of the proceeds from the sale of council houses and flats and up to 50% of other capital receipts could at the authorities' discretion be available for new capital investment. The remainder would be applied to debt redemption or set aside to meet future capital commitments or as a substitute for future borrowing. For some receipts, however, different proportions would be appropriate. For instance, if a housing authority were to dispose of all or the greater part of their housing stock, redemption of housing debt should be a first charge on the proceeds of sale. Equally, where property occupied by an authority for a particular purpose was to be replaced by other property to be used for the same purpose, it will be possible for the debt to be rolled over.

26. In proposing the percentages above, the Departments have had in mind:-

- (a) the accumulated cash receipts which under the transitional arrangements proposed will be carried forward from the 1980 system and which, it is estimated, will provide authorities collectively with spending power of £2.8 billion;
- (b) the level of new receipts likely to be realised in the early years of the new system; and
- (c) the need to accommodate within the total public expenditure provision for capital expenditure by local authorities an adequate level of credit approvals as well as the spending power arising from receipts.

Any increase in the percentages proposed above would, for any given level of gross public expenditure provision for local authority capital expenditure, imply a commensurate reduction in credit approvals.

27. Under the 1980 system, the Government may not when making allocations take any account of the ability of individual authorities to use receipts. This has seriously reduced the scope for making allocations available to those areas where needs are greater. Under the new system, the Government will be able to take into account the ability of individual authorities to finance expenditure from sources other than credit and revenue contributions. But the Departments propose when issuing credit approvals to take into account only part of spending power from receipts. They will not, however, take revenue contributions into account.

28. The Government's previous proposals (published in February 1986) for reform of the 1980 system envisaged that local authorities would be able to use all their cash receipts realised before 1 April 1987 ("old" receipts) for new capital expenditure but that only a proportion of receipts realised after that date ("new" receipts) would have been available for spending, and the rate of use of those receipts which were available (both "new" and "old") would have been strictly controlled and taken into account in setting capital allocations. The present proposals do not distinguish between "old" and "new" receipts and do not include any restriction on the rate at which council's may spend those receipts which are available or use unbudgeted revenue contributions. Bearing in mind this increased flexibility, and also the forecast growth in accumulated receipts between 1 April 1987 and 1 April 1990, the Departments consider that the present proposals are as regards services other than council housing more advantageous to local authorities, in terms of their ability to use receipts to finance capital expenditure, than those put forward in 1986. As regards council housing, the White Paper "Housing: the Government's proposals" (Cm 214) noted that the continuing success of the right to buy, which has exceeded even the Government's own expectations over the last two years is generating new capital receipts, would need to be reflected in the new capital control system. This need has been

reinforced by the prospect which has recently emerged of a number of local authorities generating substantial additional receipts from the disposal of large parts, or even the whole, of their housing stock to other landlords. Against this background of higher receipts from the sale of council housing, the Government consider it appropriate that a lower proportion of these receipts should be available to finance new investment by local authorities than was envisaged in 1986.

29. Local authorities do not generally raise specific loans to finance the acquisition of specific assets (though credit arrangements have generally been tied to specific items). It has instead been the practice for loans to be "pooled", by which means authorities can seek to manage their borrowings as a whole and thus to achieve lower overall interest rates. The new system will be consistent with this practice and will also permit monies set aside to reduce indebtedness not to be used immediately for this purpose but rather, if this will contribute to efficient management of authorities' debt portfolios, to be invested in a range of secure investments until they are needed. Such monies may also be used by authorities as a substitute for new borrowing from banks, the Public Works Loan Commissioners, or other lenders.

30. An authority who were successful in realising receipts might find that in time those set aside came to exceed both the authority's existing debt and their foreseeable programme of new investment. Some district housing authorities may presently be in this position if they succeed in transferring to the private sector all or a substantial proportion of their existing housing stock. The Departments propose that, in such circumstances, the districts concerned should have a choice between investing the surplus receipts or using all or part of them to finance capital expenditure which would

- (a) be carried out by the county councils or other statutory agencies (such as health authorities);
- (b) be for the benefit of the areas of the districts concerned; and
- (c) be in part additional to the capital resources which the counties or other agencies would otherwise have available.

In the case of county expenditure thus financed by districts, the mechanism by which this would be achieved would be that a district which had reduced their net indebtedness to zero would be permitted to lend to the county receipts which would otherwise have to be set aside to meet future commitments. The county would be able to use the full sum borrowed to finance capital expenditure but only a proportion would need to be authorised by a normal borrowing approval. The proportion will depend on the number of authorities who have reduced their net indebtedness to zero. The district would not be obliged to lend under these arrangements, or the county to borrow, but they would provide a means by which the county could enhance their capital programme, if the district were willing to assist the expenditure concerned.

Counties which had reduced their net indebtedness to zero would likewise be able to lend to assist district projects. The Departments are considering how similar arrangements could be made to enable surplus receipts of counties, districts (including metropolitan districts), and London boroughs to be used to finance additional expenditure by health authorities.

31. The new system will provide a clear framework for borrowing by local authorities from third parties. It will also specify a range of secure investments in which local authorities may invest monies (other than monies in trust and superannuation funds the investment of which will be governed by the relevant trust deeds and regulations) which they hold pending use for the purposes for which they are held.

32. Various arrangements will be specified to cover the transition from the 1980 system to the new system. Cash (or certain investments) representing unspent capital receipts from the 1980 system, will be treated in the same way as capital receipts generated under the new system. Outstanding borrowing from the 1980 system will be subject to similar amortisation provisions to those applying to borrowing under the new system. And the cost of credit arrangements entered into between the date of this consultation paper and 1 April 1990 will be charged to authorities' revenue accounts during the first five years of the new system.

#### Relationship with the new regime for local authority revenue finance

33. The Government intend to legislate for the new system in the next Session of Parliament and, subject to Parliament's endorsement, to bring it into effect from 1 April 1990. It will complement the new regime for local authority revenue finance which, if the present Local Government Finance Bill is approved by Parliament, will take effect from the same date. By regulating the way in which the financing costs of capital expenditure are charged to revenue account, it will ensure that the community charge levied is a fair reflection of capital as well as of revenue expenditure. By not continuing the practice under the 1980 system of exempting some categories of capital expenditure from control, and by allowing free use of revenue contributions for capital expenditure, it will remove an incentive for authorities to capitalise expenditure which should properly be charged to revenue account.

#### Relationship to capital accounting

34. A Working Group has recently been set up by the Chartered Institute of Public Finance and Accountancy to make proposals about the accounting for capital assets and capital financing of local authorities. It includes representatives of the Local Authority Associations and of other interested parties. The Departments do not intend that the present proposals should imply any particular accounting framework or conventions. The detailed description of the proposals in the Annex is intended to explain their substantive effect and not how capital transactions will in future be accounted for.



## Summary and assessment of the new system

35. The main features of the system outlined above are:

- \* It will set an annual limit on capital expenditure by local authorities financed by credit.
- \* That limit will apply both to expenditure financed by borrowing and to arrangements which have the same economic effect as borrowing.
- \* Part of existing and future capital receipts will be required to be set aside for debt redemption or to meet future commitments.
- \* When debt has been redeemed, such receipts may also be used to finance additional expenditure by other authorities for the benefit of the areas concerned.
- \* Local authorities will be free to finance capital expenditure from revenue and from receipts not set aside for debt redemption.
- \* Local authorities will be required to make provision from revenue for interest on, and repayments of principal of, their borrowings.
- \* When local authorities receive credit approvals for a year they will also be given provisional approvals for the following two years.

36. The Government believes that the new system will deliver the objectives outlined in paragraph 16 above. It will provide control over the underlying level of the LABR. There will be no control over the annual fluctuations in revenue borrowing and balances, but control of these could only be achieved through an EBL system, which the Government accepts is unworkable. The new system will also provide a strong influence over capital expenditure, through the control of capital expenditure financed from credit and the discipline placed on revenue contributions by the community charge.

37. It will be possible to target resources more efficiently than at present. Accumulated capital receipts will in time be reduced, leaving more room for credit approvals. And the provisions which will enable the Government to take account of part of the spending power from individual authorities' receipts when setting credit approvals will permit the overall distribution of spending power to be matched more closely to need than under the 1980 system.

38. Local authorities will have a strong incentive to make efficient use of their capital assets, to rationalise their holdings, and to dispose of surplus property. Those receipts set aside for debt redemption or to meet future commitments will reduce net loan charges and hold down the community charge. The flexibility provided by the freedom to use revenue contributions and the lifting of constraints on the rate at which other receipts can be used will make it easier than at present for rationalisations to be carried out.

39. Finally, the provisional credit approvals given for future years will provide a sound basis for local authorities to plan their capital programmes. Their planning will be strengthened by the provisions now added to the Local Government Finance Bill which will require local authorities not only to consider the interests of community charge payers when formulating their capital programmes but also to consult with representatives of business and commerce and others who will be contributing to the cost of those programmes through the national non-domestic rate. And the improved national control which the new system will provide should lead to a more stable background against which local authorities can plan.

PERSONAL AND CONFIDENTIAL

1. MR POTTER *BHP 10/6*
2. CHIEF SECRETARY

FROM: R FELLGETT

Date: 10 June 1988

cc: Chancellor  
Sir P Middleton\*  
Mr Anson\*  
Mr Phillips  
Mr A J C Edwards  
\* without attachment

1989-90 RATE SUPPORT GRANT SETTLEMENT

We have now discussed with DOE officials the fixed grant proposal which Mr Ridley put to you earlier this week.

The Fixed Grant Proposal

2. As Mr Potter foreshadowed in his submission of 3 June, Mr Ridley is not thinking of the frozen grant idea which was discussed briefly last year. That would involve an impracticable Parliamentary timetable. His approach does not, therefore, have the political attraction of being able to offer, say, Essex the same percentage increase in block grant as, say, Cleveland.

3. Instead, the RSG settlement would proceed as normal in July. But when the details were published in the autumn, the Government would announce that it would take legislation to prevent any authority losing grant in 1989-90 as a result of overspending (or gaining grant from underspending the settlement assumption), and as a quid pro quo that no further grant would be paid out for 1988-89 or earlier years if authorities declared lower expenditure. This would require a Bill, but DOE currently believe that it would be a short money Bill, to be introduced in December after the RSG settlement.

Assessment

4. The attached DOE paper describes their proposal, together with some assessment of the costs and benefits and other

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disadvantages and advantages. It has been prepared in consultation with us. We agree that it covers the main points and that the costings are adequate for their immediate purpose, although there are inevitably considerable uncertainties and the financial assessment could be refined. The scheme is still only an outline, and if you and Mr Ridley were attracted to developing it further a good deal of work would be needed.

5. We do not believe the proposal represents a good deal for the Treasury. The public expenditure argument points strongly against this proposal. Local authorities would have over a year in which they knew that additional spending incurred no grant penalty (for the first time in recent years). They would very likely be tempted to push up their spending during this "window of opportunity", while they could, for a final time, finance it in part from higher business rates. Grant pressures were last relaxed in 1986-87, with the abolition of targets and penalties, and the trend growth in local authority spending increased by about 5% or more than £1 billion. On this occasion, the additional expenditure is likely to be rather less because the relaxation in grant pressures is not so great. Our guess (and it is only a guess) is that additional expenditure of 1-3%, or £300-£800 million, covers the likely range.

6. In Exchequer grant terms, the argument is more finely balanced. Paragraph b on pages 2-3 of the paper estimates that the cost of adopting the proposal would be around £350 million, because there would be no grant underclaim in 1989-90. This figure is subject to considerable uncertainty, and indeed might be significantly higher if we do not secure a firm settlement that would reduce local authority overspending.

7. Paragraph a on page 2 sets out the extent to which the Exchequer is at risk to claims for additional grant (because of later information showing lower total expenditure) in respect of 1988-89 and earlier years if the proposal is not adopted.

This figure is even more speculative than the costs of the proposal, but is also about £350m. Of the total, about £140 million could legitimately be due to authorities if they genuinely reduce their spending, and the remaining £210 million represents the cost of possible accounting fiddles, mainly by just one authority - Westminster. However, some of this risk of additional grant could also be avoided if the present RSG system were closed down after local authorities had set their 1989-90 budgets, perhaps in July 1989, although the longer we leave close down the longer authorities have to fix their books. Closedown in July 1989, after a grant underclaim for 1989-90, is nevertheless an alternative approach which we have already discussed with DOE, without reaching any conclusion.

8. DOE officials are seeking to present the proposal as broadly neutral in terms of Exchequer grant. However, the costs look more certain than the savings, and the balance is more likely to be against the Exchequer than in its favour if the proposal is adopted. On the other hand, the proposal undoubtedly has the advantage of ensuring certainty in grant payments.

9. Apart from these expenditure and grant arguments, we have some additional concerns about the DOE proposal:

(i) by curtailing local authorities' rights through retrospective legislation, there will undoubtedly be a chorus of complaints (some invalid, but some genuine hard cases) that will be directed to Treasury as well as Environment Ministers. One cannot rule out the possibility that in certain cases we will feel compelled to make ex-gratia payments to recompense local authorities that have lost out from curtailing their ability to gain grant by reducing expenditure;

(ii) from a wider financial prospective, we do doubt the propriety of withdrawing financial rights and obligations in this way without notice or recompense, when there is no overriding economic or financial reason for doing so;

(iii) these sorts of concerns may be expressed quite vociferously in Parliament.

10. DOE do not think that it will be possible to take a final decision until the autumn, when they would know whether authorities had in fact already manipulated their accounts for earlier years or still had scope to do so at some later date. They are therefore envisaging simply a contingency plan to proceed in this way. This must be right; knowledge of such a plan must be restricted to very few people here and in DOE and it would be awkward to go through a whole E(LA) round with colleagues if there was simultaneously a firm decision of which they could not be aware.

11. I accordingly recommend that you meet Mr Ridley again briefly to discuss the proposal, and say that you see substantial disadvantages for the Treasury in it. You also have some wider reservations. On the other hand, there is something to be said for having more than one approach to the settlement in play, in case, despite the disadvantages we have identified, some version of the scheme may be needed in due course. No firm decision on the scheme, which exists only in outline, is needed now. At some stage, it will be appropriate to close down the present RSG system, although not necessarily in the way now proposed. We further understand that Mr Ridley is attracted to the scheme; it could be counter-productive to be too unreceptive. If he presses it, you could therefore accept further work on the scheme, on a contingency basis; although there would need to be a clear presumption that the RSG settlement should go ahead in the normal way.

#### E(LA) Meeting

12. The first meeting of E(LA) is to take place on 22 June. DOE will circulate their first paper - which will of course give no hint of the fixed grant option - no later than the middle of next week. We need to decide now on the Treasury's opening proposals on provision and grant and how best to present these proposals to colleagues in E(LA).

13. In your private discussions with Mr Ridley, you have indicated your position on provision (option 4 in the DOE table: roughly 2% above LA 1988-89 budgets) and grant (option B: +£520m). There remains the possibility of now taking a firmer (or a more generous) line for the first encounter at E(LA). But, quite apart from the difficulty in shifting your stance after the discussions with Mr Ridley, we believe - bearing in mind the experience of starting from a very tough position last year - that there could be advantage in putting forward option 4B as a credible opening package (and dressed up as a generous offer). Given that Mr Ridley has not moved from option 2A, we would recommend against a more generous starting position on provision or grant at this stage.

14. We will provide full briefing for the E(LA) meeting in due course. Our present views are:-

- i) that the Treasury option 4 on provision and option B on grant should be included in the DOE paper for E(LA). We do not want option 3 to appear as the 'extreme' case. It also facilitates the discussion if E(LA) can work on one set of tables which describe the options and their impact on rates and grant underclaim;
- ii) that you should write to colleagues arguing for option 4 on provision and option B on grant - probably in the form of a paper to E(LA); the paper would
  - first display the principal arguments against the profligate settlement proposed by Mr Ridley: in particular it would question the need for high grant in pursuit of popular low rate increases in the last year of rates and, because of its longer-term significance, present our familiar arguments against a fixed grant percentage and in favour

of pressure on local authorities to restrain their excessive spending;

- second indicate that, despite those strong arguments, you are reluctantly prepared to provide a full £520m in order to maintain grant in real terms in 1989-90 (option B); the paper should suggest this was a break from past unrealistic Treasury negotiating stances on grant; you would also support option 4 on provision - but perhaps hint that you recognise there are arguments for being a little more generous on provision but not on grant.

We therefore envisage that you would make very little movement if any on grant in the first E(LA) discussion; but it may be possible to move to option 3 on provision, in response to the pressure from Departmental Ministers.

15. If you are content, we will provide a draft paper for you to circulate to colleagues early next week.

*Robert Fellgett*

R FELLGETT



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1989/90 RSG SETTLEMENT : CLOSING DOWN THE RSG SYSTEM

This paper describes an option for closing down the RSG system at the time of making the 1989/90 RSG settlement. The paper is divided into 5 sections. The first describes how the arrangement would work and the timetable for its implementation. The second describes the main policy points on grant and expenditure. The third section discusses the legal and parliamentary issues. And the final two sections describe the advantages and disadvantages associated with this option.

DESCRIPTION OF CLOSING DOWN OPTION

The main feature of this proposal to close down the RSG system is that grant entitlements for 1989/90 would be calculated on the basis of the settlement spending assumption rather than on the basis of local authority reported expenditure. This means that the amount of grant paid out would be the amount specified in the settlement : there would be no grant under claim as in 1987/88 and 1988/89 but nor would there be any risk of a grant overclaim. Having fixed grant entitlements before the beginning of the grant year there would be no subsequent revisions.

Final grant entitlements in respect of all earlier years would also be calculated before April 1989. These would be determined on the basis of Supplementary Reports due to be made around the time of the 1989/90 settlement. It is in a way fortuitous that SRs are due to be made in respect of all outstanding years at this time and this option seeks to capitalise on this.

No further changes to grant entitlements under the present system would be made after March 1989 in respect of any years.

The key steps would be : -

- a. July : announcement on settlement as usual;
- b. October : Consultation paper on settlement as usual;
- c. October : Closedown on data for settlement and 1987/88 and 1988/89 SRs;

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DOWN THE  
RSG SYSTEM  
DOE PAPER

- d. November : Closedown on data for 1985/86 and 1986/87 SRs 9 (later for these reports as they are not being laid until January);
- e. November/December : announcement on Settlement Day that a Bill will be introduced to closedown system taking account only of information used (or to be used) in the settlement and supplementary reports : grant entitlements for 1989/90 to be based on settlement spending assumption so full AEG to be paid out.
- f. December : debate and approve RSG Report and SRs for 1987/88 and 1988/89;
- g. December : introduce (Money) Bill;
- h. December : make provisional Rate limits;
- i. January : lay and debate SRs for 1985/86 and 1986/87;
- j. February : determine final Rate limits;
- k. March : Royal assent to Bill allowing payment of grant in April to be on basis of settlement spending assumption;
- l. April : implement final grant changes in respect of all years prior to 1989/90 and commence payment of 1989/90 grant entitlements based on settlement spending assumption.

#### GRANT AND EXPENDITURE IMPLICATIONS

The main grant implications are :

- a. Grant claims in respect of 1987/88 and 1988/89 are likely to be lower with this option because authorities will not have further opportunities to manipulate total expenditure to increase grant claims after October 1988. Experience with ending of the targets and holdback regime indicates that there is considerable scope for such manipulation of total expenditure. Early closedown could save the Treasury around £70m each year arising from normal reductions in current expenditure between budgets and outturn; £155m from use of special funds by Westminster, and £55m from use of special funds by other authorities. The total sum at risk for these reasons is thus around £350m. Treasury would also be at risk from further increases in the grant claim arising from other manipulations of total expenditure in respect of these years.
- b. The grant claim in respect of 1989/90 will be fixed at the settlement level. This means that Treasury forgo the potential underclaim which might arise if authorities spend above the settlement spending assumption. On the basis of option 2A (Mr

Ridley's option) and for spending at 7½% above 1988/89 budgets the underclaim would be £287m and on option 4B (the Chief Secretary's option) and for spending at 6% above 1988/89 budgets the underclaim would be £349m. But the grant underclaim could be £90m lower if Westminster were to make full use of special funds in 1989/90. The grant claim could also be increased through other manipulation of total expenditure such as factoring, capitalisation of expenditure, interest rate swaps, use of other funds such as the HRA, and other forms of creative accounting not yet dreamt of. For every 1% reduction in expenditure the grant claim would increase by around £150m.

Much of this assessment of additional grant claims is necessarily speculative but the risk of higher grant claims under the present grant system is very real. Over the three year period the scope for such manipulation to increase grant is certainly greater than the likely grant underclaim in 1989/90. With a later closedown of the system it might still be possible to cut off some of the potential higher grant claims in respect of 1987/88 and 1988/89 but by then authorities may have taken the opportunity to increase considerably the grant claim for 1989/90.

There are also potential implications for local authority current expenditure in 1989/90. Local authority public expenditure is likely to be higher in 1989/90 (and to a much smaller extent in 1988/89) if this option is adopted. Authorities will be able to finance additional expenditure without losing grant, as they could not have done in any other recent year. Of course, some part of the cost of any extra spending would fall on domestic local tax payers but local authorities would for the last time be able to finance just over half the higher spending from higher business rates. Authorities would be aware of this window of opportunity for additional expenditure when they set their budget for 1989/90. Each extra 1% of spending would be about £300m.

#### LEGAL AND PARLIAMENTARY ISSUES

There are a number of legal and parliamentary implications with this option. First it requires an additional Bill to implement closedown before April 1989 so that grant can be paid out on a correct basis in 1989/90. We believe that it will be a short Bill and on past precedent that it should be a Money Bill. It should therefore be possible to obtain Royal Assent by March if the Bill is introduced in December.

The Bill will be introduced at the same time as the settlement. This means that Parliament will be asked to debate and approve the RSG settlement when it has before it a Bill that will change the basis on which grant is calculated. However, our lawyers advise that this is reasonable since all the determinations in the Report stand irrespective of the Bill. All that the Bill will change is the total expenditure figure to be used in the Section 66(1) calculation of grant entitlements.

As set out here this closedown arrangement would not be announced until Settlement Day. This means that all consultation on the Settlement with local authorities will arguably have been carried out on a different basis to the actual Settlement. We could avoid this by announcing the closedown option at the time we go out to formal consultation on the Settlement : but we need to consider how this would fit with our proposed closedown dates for information for the Settlement and SRs, and with the Parliamentary timetable. If we do make the announcement on Settlement Day we may have to take powers in the Bill to validate the consultation process.

There is also the question of whether we should use the Bill to prevent any further legal challenges to the Settlement and the Supplementary Reports being made in the autumn. There are obvious attractions in doing so in that we would be certain that the system was properly closed down. But it would make passage through the House more difficult. This matter and similar issues will need to be considered when we have worked up the options in more detail.

If Ministers agree that this option shall be pursued we will need to obtain the advice of the Attorney General urgently on the proposed legislation and the proposed timetable.

#### ADVANTAGES

The main advantages for Central Government are : -

- a. Treasury would know in November (and pretty accurately in July) how much grant has to be paid out under the present system for all years;
- b. The present system would be closed down in an orderly fashion well before the introduction of the new system;
- c. It would prevent authorities from manipulating expenditure to increase grant claims from October onwards;
- d. On settlement day Ministers would be able to announce that the full amount of AEG would be paid out in 1989/90.
- e. It reduces the risk of further emergency legislation to patch up the present system e.g. to outlaw new creative accounting arrangements;
- f. it would avoid the need for further supplementary reports and debates after the forthcoming round.
- g. There would be no overhang of the present system during the early years of the new system which otherwise might lead to some loss of accountability in the new system;

The main advantages for local authorities are : -

- a. Certainty about grant entitlements in 1989/90 and all later years i.e. no grant changes in 1990/91 and later years arising from the old system;
- b. Unlike recent years local authorities would receive the full amount of grant being made available in the settlement;
- c. Local authorities will be free to direct their resources to setting up the new system rather than worrying about the present system;
- d. There will be an orderly closedown of the present system and a smooth transition to the certainties of the new system.

**DISADVANTAGES**

The main disadvantages for Central Government are : -

- a. The removal of grant penalties means lower pressure on local authority expenditure during 1989/90; this means that local authority expenditure might be higher than it might otherwise be;
- b. An additional Bill, albeit probably a short Money Bill, would be required so that grant payments on the correct basis could be made from the beginning of the 1989/90 financial year;
- c. There would be no grant reduction in 1989/90 in the event of overspending by local authorities;
- d. The Secretary of State would have to announce the RSG settlement to LAs and Parliament on one basis in mid-July and on a different basis in the outturn settlement;
- e. Information on the proposal to legislate would have to be restricted on a strict "need to know" basis to avoid the proposal leaking; any premature release would alert local authorities to need to act quickly in order to manipulate the system to their advantage;
- f. Ministers can expect a good deal of flack from local authorities claiming that basing closedown on 1988/89 budgets was unfair to them. Some of these complaints would be justified. (This is, of course, inherent in any early closedown arrangement).
- g. Local authorities have until October to manipulate expenditure to increase grant entitlements in respect of 1987/88 and 1988/89.

- h. Rate limitation would be less severe for authorities with redetermined expenditure levels. This arises because the grant entitlements used in the calculation of rate limits could not take account of the proposed legislation so would be assumed to be lower than provided for in the Bill.

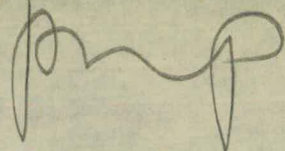
For local authorities the main disadvantages are : -

- a. They would not gain additional grant for genuine reductions in expenditure below the settlement spending assumption;
- b. They would be unable to manipulate total expenditure after October to maximise grant entitlements;
- c. The proposal would benefit local authorities that used accounting arrangements, such as use of special funds, to increase grant in 1988/89 and disbenefit authorities that were planning to use such arrangements in 1989/90;
- d. There would be hard luck cases about how 1988/89 total expenditure, which underlies the 1989/90 settlement assumption, is "exceptional" and authorities are therefore being unfairly treated over grant entitlements in the last year of the present system.
- e. Depending on the precise form of the legislation it may not be possible to correct any "errors" in the 1989/90 Settlement though of course we hope that there will be no such errors;

Department of the Environment  
10th June, 1988

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FROM: MR A J C EDWARDS

DATE: 10 June 1988

CHIEF SECRETARY

cc PS/Chancellor  
 Sir P Middleton  
 Mr Anson  
 Mr H Phillips  
 Mr Turnbull  
 Mr Potter  
 Mr Fellgett

*The letter pm 2.6 X...*

## 1989-90 RSG SETTLEMENT: 'FIXED GRANT' PROPOSAL

I agree with the minute submitted by Mr Potter and Mr Fellgett, which reflects discussion between the three of us.

2. We understand that Mr Ridley is much attracted (as are some, but not all, of his officials) by the idea of a 'fixed grant' RSG deal for 1989-90. In our view, this is a bad idea. We hope therefore that it may be possible for you to see Mr Ridley on Tuesday, as earlier envisaged.

3. What the fixed grant proposal means, in simple terms, is that Mr Ridley would simultaneously in the autumn -

- a. announce the level of grant for each local authority in 1989-90, and
- b. introduce primary legislation to preclude any adjustments to the 1989-90 grant figures and any further adjustments to the grants for earlier years.

The effect of element (b) would be to bring the existing RSG system by diktat to a premature end ('from midnight tonight').

4. As explained in the accompanying minute, fixed grant looks to be a bad financial deal from the Treasury's point of view. Element (a) would gravely weaken the restraints on total local

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authority spending in 1989-90. It would also require the government to provide an extra amount of grant tentatively estimated at £350 million resulting from the loss of grant underclaim.

5. Element (b) would in principle produce a saving in government grant to set against the loss of underclaim. On DOE's own admission, however, there is no solid basis for supposing that the saving would exceed the loss on underclaim. It would moreover be partly bogus in that we would reckon to obtain a considerable saving under whatever scheme is introduced for closing down the existing RSG system. The DOE estimate also assumes, unrealistically, that local authorities would not anticipate the possibility of such a pre-emptive strike by the DoE and would not therefore arrange their accounts so as to pre-empt the pre-emptive strike.

6. The other great difficulty with the fixed grant proposal, as I see it, is that it would breach so many principles of good financial practice. The government would be accused of (a) altering the rules unilaterally in mid-game, (b) doing so in a way which would not only be profoundly inequitable as between local authorities but would actually reward the wicked while penalising the virtuous, and (c) misleading local authorities and Parliament. DOE would doubtless take most of the flack. But we as Treasury would, I think, be much embarrassed if asked whether we had approved this way of conducting financial business. Moreover, DOE would I suspect be likely to come to us with requests for extra grant to cover 'hard cases'.

7. Mr Ridley will doubtless be unwilling to drop the fixed grant idea completely at the first whiff of grapeshot. For the reasons discussed above, however, I endorse the advice that you should make clear to him your severe misgivings about the idea. We would advise you likewise against any kind of pact whereby our two departments would secretly have a fixed grant scheme in mind during the forthcoming E(LA) discussions and against accepting (as DoE protagonists would like us to do) that a fixed grant solution can be regarded as 'grant-neutral' or 'expenditure-neutral' compared with the existing system.



8. Looking ahead, there is undoubtedly an important policy question as to how the existing RSG system will best be wound up. My instinct is that a far better approach would be -

a. to complete the unfinished business of the existing system in the context of next year's grant settlement (when Mr Ridley and others will be arguing for a generous settlement to lighten the impact of the community charge) and

(b) to avoid charges of retrospection, inequity and misleading Parliament by giving local authorities a couple of months to make their final grant claims under the existing system, on the basis that all these will have to be settled within the total grant figure for 1990-91 (which will be higher than it would have otherwise have been).

We shall need, obviously, to think a great deal more about all this.

X 9. In the meantime, the Treasury arguments continue in our view to point to a robust grant settlement this year. We would not accept Mr Ridley's argument that leniency is needed this year in order that local authorities should not run down balances which could help to keep the community charge down in 1990-91. There would be no guarantee that the authorities would maintain balances. They might well choose to spend more. A more efficient way to lighten the financial burden on local authorities next year (if the government should so decide) would be to set next year's grant with that in mind.

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10 DOWNING STREET  
LONDON SW1A 2AA

From the Private Secretary

13 June 1988

Dear Roger,

LOCAL AUTHORITY CAPITAL EXPENDITURE AND FINANCE

The Prime Minister was grateful for your Secretary of State's minute of 9 June and the enclosed draft consultation document on control of local authority capital expenditure.

The Prime Minister is content for the consultative document to be issued along the lines proposed. She has commented that the draft foreword is very good. She would be grateful however if a further look could be taken at the detailed drafting on two points.

First, she thinks it is important that the document should make as clear as possible the position for accumulated receipts; for example explaining the difference between the figure of £10 billion in paragraph 10 for nominal accumulated receipts, the £6 billion figure for unspent accumulated receipts that can be deduced from that figure, and the £2.8 billion of accumulated cash receipts referred to in paragraph 26. Although the Prime Minister recognises the difficulties of explanation in this area, she thinks it important to try to explain more clearly the term "cash receipts" and suggests an additional paragraph be inserted to clarify this issue.

Second, she thinks the material on local authorities being allowed to transfer spending power to other authorities might be expanded. She understands that the intention underlying paragraph 22 of the draft is that local authorities will be able to transfer to any other authority part of their basic credit approval and also any proportion of the part of their receipts they can spend. She suggests this might be discussed more fully in an additional paragraph before paragraph 30, which refers only to transfer in the limited case that the local authority making the transfer has redeemed all its outstanding debt.

The Prime Minister has also commented that it may be necessary to consider further the arrangements mentioned in the last sentence of paragraph 25 whereby local authorities would be allowed to "roll over" debt where property occupied for a particular purpose is to be replaced by other property to be used for the same purpose. She thinks the Government

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should keep an open mind at this stage on whether some further help may need to be given to local authorities in such circumstances. But she is content with the drafting of the consultation paper on this point, and considers this is a point that can be considered further if necessary after responses to the paper have been received.

I am copying this letter to Private Secretaries to members of E(LF) and to Sir Robin Butler.

*Yours,*

*Paul*

—  
PAUL GRAY

Roger Bright, Esq.,  
Department of the Environment.

14/6/88

Ch  
Partly explains PM's  
sentiments about  
charities/churches  
Prime Minister & VAT



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COMMUNITY CHARGES: CHURCHES

I have been under pressure from the Churches Main Committee, representing all of the main church groups, and chaired by the Bishop of London, about the direct impact which the Bill will have on church finances.

The position under the present law is that the houses of ministers of religion benefit from a mandatory 50% rate relief. This is in addition to the total exemption from rates of churches and the virtual exemption of church halls. The Churches Main Committee has been very concerned that with the advent of the community charge they will lose the benefit of the rating relief on the homes of the clergy and that they will have to find, directly or indirectly, another £6 million per annum to meet increased local government charges.

In my discussions, the Committee had made it clear that they are not seeking special treatment for ministers of religion as such, but they are concerned about the financial implications for churches and the fact they are losing a concession which is presently available to them. I have made it clear that I could not contemplate any special provisions for ministers of religion in relation to the community charge. I am nevertheless sympathetic to their general concern about the extra costs they will now incur. I propose, therefore, that the benefit of the existing rating concession on the homes of the clergy should be translated into one for ancillary non-domestic buildings used to support the organisation of religious worship by any body registered as providing public religious worship. I intend this concession to cover buildings used for central or diocesan administration as well as seminaries for the training of priests. I do not, however, see it including buildings used for quasi commercial purposes such as publishing or bookshops - though they



would continue to be eligible for any relief they get at present. The full value of the exemption I am proposing is estimated to be £1.5 million in a full year.

Even with this concession, the churches estimate that collectively, they will be £4.5 million a year worse off. This will affect their ability to engage in other activities to which we attach some importance, like the preservation of our heritage churches or the programme for redundant churches. I am therefore pursuing separately with the Chief Secretary, in the context of my PES bid, some increase in the provision for these activities.

Only the alteration to the rating exemption will require us to amend the Local Government Finance Bill. Time is now short and I should be grateful for early agreement to instruct Parliamentary Counsel to prepare the necessary amendments.

I am copying this letter to the other members of E(LF) and to Sir Robin Butler.

*R. Biggs*

NR  
14 June 1988

*(approved by the Secretary of State and signed in his absence).*

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FROM: B H POTTER

DATE: 15 June 1988

— !

CHIEF SECRETARY

- cc Sir P Middleton
- Mr Anson
- Mr Phillips
- Mrs Case
- Mr Edwards
- Mr Turnbull
- Mr MacAuslan
- Miss Noble
- Mr Richardson
- Mr Saunders
- Mr Wood
- Mr Betenson
- Mr Rea
- Mr Call

sh  
17/6

LOCAL AUTHORITY CAPITAL: DRAFT CONSULTATION PAPER

The Secretary of State for Environment's minute of 9 June to the Prime Minister covered a further revised draft of the consultation paper on the new local authority capital control regime.

2. The revised paper sets out substantially the same control scheme as the draft circulated by Mr Ridley on 15 March and discussed in my submission to you of 22 March. But two new proposals have been added following the further discussions at E(LF)(88)4th Meeting in April:

(i) that capital receipts from housing should also be covered by the new capital control regime; and

(ii) that there should be provision for local authorities to transfer some of their capital receipts to other local authorities or to health authorities.

3. You may recall that the latter idea came from the Prime Minister in the context of discussions on housing at E(LF). The Prime Minister has already responded to Mr Ridley's minute of

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9 June and, while approving the consultation document in general, is seeking clarification of the proposals on transfers of spending power by local authorities.

### Housing

4. It is now proposed that the capital control system should cover housing capital, both expenditure and receipts. But the proportion of housing capital receipts which local authorities will be able to spend has been set at 25% in the draft consultation paper, rather than 50% as for other local authority capital receipts. (The remaining proportion must be paid into each authority's proposed Capital Fund Account, to extinguish outstanding debt). 25% is a slightly lower figure than the 30% originally envisaged and discussed at official level. And any figure below about 35% is likely to provoke a hostile reaction from local authorities, particularly from the Association of District Councils. Our understanding is that DOE have put in a low figure with the idea of raising it in response to the inevitable outcry from the district councils during consultation. LG2 advise that there are no particular housing reasons for disputing the 25% proposal.

### Redistribution of Surplus Receipts

5. Following the E(LF) meeting referred to earlier, Mr Ridley was asked to consider how capital receipts might be transferred to other authorities in particular from districts to counties. The scheme described in paragraph 30 of the draft would involve those local authorities with no outstanding debt remaining and hence "surplus" receipts being able to lend some of these receipts to other authorities within the same geographical area. But the outline scheme poses at least three problems.

6. First, No.10 are unhappy with the proposals. The DOE approach would confine the scheme to authorities with surplus receipts. In the short-term very few authorities will be in such a position - though their number will grow, particularly if large scale housing disposals take place. The Prime Minister seems

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to have had in mind a much more ambitious arrangement (though this is not reflected in the E(LF) minutes). This would allow local authorities to transfer not only capital receipts but also their other main source of spending power - their credit approvals (ie borrowing permissions from central government) - to other authorities

7. We are not attracted to a general scheme for transferring spending power from one authority to another, ie capital receipts and credit approvals. No local authority will voluntarily transfer its own credit approvals - a one-year borrowing provision from central government - to another authority. Giving financial incentives to encourage them to do so would be perverse and inefficient and risk adding to total LA capital expenditure. Why allow credit approvals, based on central government's assessment of each LA's needs, to be transferred? We agree with DOE that any scheme should be confined to transfers of capital receipts. We also agree that it should apply only to authorities with 'surplus' receipts. It must remain the case, as Ministers decided last year, that the first claim on all capital receipts should be the extinction of outstanding debt. Authorities should not be permitted to lend receipts while they still have outstanding debt (making a profit in doing so).

8. Secondly, we need to be sure that a narrower scheme for authorities with surplus receipts does not lead to higher expenditure overall. In order to make the scheme attractive there would have to be incentives on LAs to participate; and that inevitably would lead to pressures for such spending to be additional. The present draft of paragraph 30 hints at all this but in a rather obscure way: it will need to be revised to refer to local additionality (so that we have scope to net off forecast use of the arrangement in determining credit approvals at the national level). This clarification of the consultation paper will no doubt put the local authorities off the idea. Neither we nor DOE officials would be particularly unhappy at that prospect.

9. Finally, again in line with the conclusions at the E(LF) discussion, the revised draft proposes that 'surplus' capital



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receipts might also be transferred to health authorities. Currently health authorities have no borrowing powers. Although Mr Ridley is considering whether a transfer of a grant rather than a loan might be allowed, this would still set an unwelcome precedent. The present imbalance in health authorities' income and expenditure accounts is in part due to the current expenditure consequences of the capital programme. One of our objectives in the Survey will be to get this engine of growth under better control. Giving health authorities access to additional funds for capital projects would frustrate this and be likely to generate current expenditure requirements which may not be sustainable from income available.

10. Any extra money from local authorities should therefore be offset by a reduction in the voted expenditure for capital. But this could lead to a distortion of priorities in the HCHS capital programme. Projects financed by receipts transferred from local authorities could be going ahead at the expense of better schemes which would have been fired from the HCHS capital vote. Similarly those regions where the local authorities had surplus receipts to transfer would stand to do better than others. Mr Ridley's proposal is therefore not something we would wish to pursue.

**Conclusion**

11. Mr Ridley is right to emphasise in his covering minute the importance of getting a draft consultation paper agreed quickly and circulated. But I think the difference of views between No.10 on the one hand and DOE and ourselves on the other about the scope of the scheme for transferring spending power needs to be resolved. Moreover No.10 Policy Unit has hinted - without any commitment of course - that the Prime Minister might be persuaded to narrow the scope of the scheme to authorities with surplus receipts.

12. I therefore recommend that you write to Mr Ridley endorsing the broad shape of the capital control regime; accepting his proposals on the treatment of housing capital receipts; supporting

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his view that the scheme for transferring spending power should be narrowed to authorities with surplus receipts (and refer to local additionality as being the incentive); and rejecting the idea that the scheme might extend to health authorities.

13. This advice has been agreed with GEP, LG2 and ST. I attach a draft letter for you to send to Mr Ridley.

Barry H. Potter

**BARRY H POTTER**

**CONFIDENTIAL.**

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**DRAFT LETTER TO THE SECRETARY OF STATE FOR THE ENVIRONMENT****LOCAL AUTHORITY CAPITAL CONTROL REGIME**

Thank you for copying to me your minute of 9 June to the Prime Minister covering a revised draft of the consultation paper on the control of local authority capital expenditure. I have also seen a copy of the letter of 13 June from the Prime Minister's Private Secretary to yours.

I appreciate that the consultation paper needs to be issued as soon as possible and I remain content with the broad capital control regime proposed. I also agree that the new scheme should apply to housing and I am content that the proportion of housing receipts which local authorities will be allowed to spend on capital projects should be set at 25% in the consultation document.

I share however the Prime Minister's concern about the drafting of paragraphs 22 and 30 in the consultation document which describe the proposals to transfer spending power from one local authority to another. We have of course not discussed this further at Ministerial level since the E(LF) meeting in April. But my own view is that any such scheme should be confined to transferring capital receipts and only those local authorities with surplus receipts should be eligible. For other authorities still in debt, the first call on any capital receipts should be the extinction of

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outstanding debt. I do not see a case for any easing of the requirement to repay debt from the proceeds of assets built with public money, until all such outstanding debt is relinquished.

However I would be prepared to go along with a more limited scheme which applied to those local authorities with surplus receipts, providing there are no implications for total local authority capital expenditure. I think the draft in paragraph 30 would therefore need to make clear that the incentive on local authorities to participate in such schemes would involve some element of local additionality. Any such scheme could not be allowed to add to aggregate capital spending by local authorities and would therefore need to be taken into account in determining credit approvals at the national level.

Finally I am particularly concerned at your proposal for the scheme to allow surplus receipts to be transferred to health authorities for capital projects. The additional capital spend would inevitably generate current expenditure requirements which might not be sustainable from the income available to ~~local~~<sup>health</sup> authorities. To avoid such problems arising I consider that any transfers from local authorities would have to be offset by a reduction in the voted allocation for capital expenditure. However, this in turn could lead to a distortion of priorities in the NHS capital programme. Overall therefore I think it would be better if health authorities were not included in such a scheme.

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I am copying this minute to the Prime Minister, the other members of E(LF) and to Sir Robin Butler.

**[J.M]**



pay

Ch

This does all put  
a rather different  
complexion on things.  
Difficult to know which  
way to go ~~until~~ until  
further advice from  
officers received

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cc:

PS/Chancellor  
Sir Peter Middleton

Mr Anson

Mr H Phillips

Mrs Case

Treasury Chambers, Parliament Street, SW.

Mr Edwards

Miss Peirson

Mr Turnbull

Mr Potter

Mr Fellgett

Mr Call

Roger Bright Esq  
Private Secretary to the  
Secretary of State for the Environment  
Department of the Environment  
2 Marsham Street  
London  
SW1

15 June 1988

*Dear Roger,*

#### 1989-90 RATE SUPPORT GRANT SETTLEMENT

Your Secretary of State accompanied by Mr Osborn and Mr Roberts came to discuss the 1989-90 Rate Support Grant Settlement with the Chief Secretary. Also present were Mr Potter and Mr Fellgett from the Treasury.

Your Secretary of State said that the first issue to decide was when to close down the existing RSG system. That would have an impact on the appropriate settlement for 1989-90. An early closedown had been discussed in DOE and he noted that there were some worries on propriety.

The Chief Secretary said that he had two reservations about the proposal in the DOE paper. The first was political. He saw considerable difficulty in going through a normal RSG settlement and then switching to an entirely different basis mid-stream. This could anger colleagues and lead to accusation from local authorities that consultation had been undertaken on a false prospectus. Your Secretary of State agreed that these did present difficulties but noted that the action the Government was taking would simply stop local authorities manipulating the system to their benefit and to the Exchequer's cost. Continuing, the Chief Secretary said his second concern was on the financial impact of a fixed grant settlement next year. The Government would lose the grant underclaim in 1989-90. Moreover, there would have been no grant incentive in the new system for local authorities to reduce their spending - the control over the non-domestic rate that would exist in the new

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system would not be in place. He also saw presentational difficulties in appearing so obviously to reward vice and penalise virtue. Procedurally he saw difficulties in trying to keep the proposal under wraps until the announcement.

Your Secretary of State said that he did not dissent from the Chief Secretary's conclusions. But he pointed out that there was a potential reclaim of grant of up to £350 million worth of grant for 1987-88 and 1988-89 and that next year there was a possible grant overclaim of £450 million. Mr Roberts explained that the £350 million was identifiable from the DOE's knowledge of local authorities' potential genuine underspending and from use of special funds in those years. The future number was inevitably more speculative. Your Secretary of State added that the objections the Chief Secretary had outlined to closing down the RSG system would apply whenever it took place. But without action to close down the system the Exchequer was at permanent risk that the local authorities would use the £1½ billion funds available to them to reduce expenditure and reclaim grant. He accepted that this was an argument for a tighter RSG settlement in 1989-90. Mr Fellgett said that grant effects could be forestalled by assuming that the funds would be drawn down. Your Secretary of State said that he was concerned that authorities would draw down the funds next year and then restore them in the first year of the community charge, blaming the Government for high community charges in the initial year while picking up the additional grant available in 1989-90. He pointed out however that the incidence of funds was patchy.

The Chief Secretary said that the figure of £450 million was new to him and had not been put previously to Treasury officials. He would wish to look at this point further. His reaction going into the meeting was that the balance of advantage was against an early closedown of the RSG system. Your Secretary of State said that the issue would need to be looked at carefully to see how to limit Exchequer liability. Mr Osborn said one option would be to re-introduce the block grant cash limit which had been abolished in 1987-88. The Chief Secretary suggested that officials should look at the estimate of the 1989-90 overclaim and to look at ways of achieving a cost effective closedown.

Your Secretary of State said that taking the final three years of the RSG system together some £800 million was at risk. If reclaim of that money could not be stopped it would have to be considered to what extent the Rate Support Grant could be reduced to offset that effect. That had the presentational difficulty of reducing grant to well below the levels mentioned in the context of the first year of the Community Charge. That was an argument for choosing the closedown route instead. However, his preference was to avoid further legislation if it was possible. There were presentational difficulties in simply cutting RSG to compensate while allowing those with



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balances to exploit the system. The Chief Secretary thought that officials should see if there was a way of producing a system which would be defensible. Your Secretary of State agreed that there was a considerable dilemma here. The Chief Secretary said that once he and Mr Ridley had seen the arguments set out it might be sensible to put a paper to the Prime Minister, the Chief Whip and the Chancellor. It would not be appropriate to go wider than such a restricted group in view of the sensitivity of the proposals.

The Chief Secretary noted that discussions should proceed in E(LA) in the normal way meanwhile. Your Secretary of State said that colleagues' attention would have to be drawn to the fact that there was a risk of a massive drawdown of balances in the last year of the system. That would point toward a much more restrictive settlement than he had envisaged before he had become fully aware of this problem and, if the system was not closed down, pointed to his moving below option (ii) on provision and grant that he had preferred.

Yours,

Jill

JILL RUTTER  
Private Secretary

Mr  
Parsons  
swely?



Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Nicholas Ridley AMICE MP  
 Secretary of State of the Environment  
 Department of the Environment  
 2 Marsham Street  
 London  
 SW1P 3EB

*Can't have  
 advice on  
 which this  
 broad pt.*

17 June 1988

*h*

*Dear Secretary of State,*

#### LOCAL AUTHORITY CAPITAL CONTROL REGIME

Thank you for copying to me your minute of 9 June to the Prime Minister covering a revised draft of the consultation paper on the control of local authority capital expenditure. I have also seen a copy of the letter of 13 June from the Prime Minister's Private Secretary to yours.

I appreciate that the consultation paper needs to be issued as soon as possible and I remain content with the broad capital control regime proposed. I also agree that the new scheme should apply to housing and I am content that the proportion of housing receipts which local authorities will be allowed to spend on capital projects should be set at 25% in the consultation document.

I share however the Prime Minister's concern about the drafting of paragraphs 22 and 30 in the consultation document which describe the proposals to transfer spending power from one local authority to another. We have of course not discussed this further at Ministerial level since the E(LF) meeting in April. But my own view is that any such scheme should be confined to transferring capital receipts and only those local authorities with surplus receipts should be eligible. For other authorities still in debt, the first call on any capital receipts should be the extinction of outstanding debt. I do not see a case for any easing of the requirement to repay debt from the proceeds of assets built with public money, until all such outstanding debt is relinquished.

However I would be prepared to go along with a more limited scheme which applied to those local authorities with surplus receipts, providing there are no implications

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 TO  
 RIDLEY  
 17 JUN

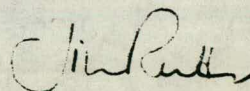
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for total local authority capital expenditure. I think the draft in paragraph 30 would therefore need to make clear that the incentive on local authorities to participate in such schemes would involve some element of local but not national additionality. Any such scheme could not be allowed to add to aggregate capital spending by local authorities and would therefore need to be taken into account in determining credit approvals at the national level.

Finally I am particularly concerned at your proposal for the scheme to allow surplus receipts to be transferred to health authorities for capital projects. The additional capital spend would inevitably generate current expenditure requirements which might not be sustainable from the income available to health authorities. To avoid such problems arising I consider that any transfers from local authorities would have to be offset by a reduction in the voted allocation for capital expenditure. However, this in turn could lead to a distortion of priorities in the NHS capital programme. Overall therefore I think it would be better if health authorities were not included in such a scheme.

I am copying this letter to the Prime Minister, the other members of E(LF) and to Sir Robin Butler.

Yours sincerely,



PP JOHN MAJOR

(Approved by the Chief Secretary  
and signed in his absence).