

PO-CH/NL/0251

PART H

Part H.

**SECRET**  
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begins: 1/7/88.  
Ends: 26/7/88.

  
PO -CH /NL/0251  
  
PART H

Chancellor's (Lawson) papers:

THE COMMUNITY CHARGE AND  
SETTLEMENT OF THE RATE  
SUPPORT GRANT SYSTEM

PO -CH /NL/0251  
PART H

Disposal Directions: 25 Years



27/9/95.



FROM: A C S ALLAN

DATE: 1 July 1988

PS/CHIEF SECRETARY

cc Sir P Middleton  
Mr Anson  
Mr Edwards  
Mr Potter  
Mr Fellgett  
Mr Tyrie

**RSG 1989-90 AND CAPITAL RECEIPTS**

The Chancellor was grateful for the Chief Secretary's minute of 30 June and agrees that the package represents a satisfactory outcome. It is vital now that it is made to stick.

A handwritten signature in dark ink, appearing to read "ACSA", with a horizontal line underneath.

A C S ALLAN

CH/EXCHEQUER

2 of 10

1/7/88



REC.	1-JUL 1988
ACTION	
COPIES TO	

Prime Minister

1989/90 RSG SETTLEMENT

The Chief Secretary and I have identified a potentially serious risk that in the last years of running the present Rate Support Grant (RSG) system local authorities could manipulate the system to attract large additional sums of grant from the Exchequer. We also see dangers that they might use the final year of the present system to incur additional public expenditure. The attached paper identifies the issues and the options we have found for dealing with them.

In our view the way forward is as follows. We should act early to remove the present open-ended commitment on grant and to close down the present system in an orderly way in England and Wales before we introduce the new grant system in 1990. If we do not act to close down the system early it will continue to operate until spring 1992. The proposals would not, of course, apply to Scotland.

There are a number of ways of closing down the system early. The one we favour would be to make an early announcement - next week - that grant entitlements for 1989/90 would be fixed in the RSG Settlement and would not vary with an authority's actual expenditure next year. At the same time, to avoid manipulation of grant in earlier years, we would make final determinations of grant entitlements for all outstanding years including 1988/89.

This option has the advantage of minimising the period at which the Exchequer is at risk to higher grant claims. It has the disadvantage that by abolishing grant penalties it reduces the pressure on authorities to restrain expenditure before 1990; however if we allow authorities excess Exchequer grant that will of itself encourage them to spend more. The alternative is to wait until next summer before close down. But by then much of the grant at risk may have already been claimed and spent.



I have discussed with the Chief Secretary the grant that can be made available under our preferred option. I have agreed with him that it would be appropriate to provide £13,575m: this is £600m more than we originally provided for 1988/89 (after technical adjustments) and £1.1bn more than is actually being paid this year, since local authorities have lost about £500m of grant from the Settlement assumptions because of their overspending. It means that rate rises should on average be around 6% on the assumption that authorities again raise spending by around 7%.

Our preferred option requires an additional Bill next session. This is regrettable. But primary legislation will be necessary at some stage if we are to close down the present system before 1992. And, if we continue with the present system, further legislation may be necessary to close down new dubious accounting practices that may come to light. Fortunately the Bill I envisage will be only 2 to 3 clauses and will be a Money Bill.

### Capital

The Chief Secretary and I are also concerned on the capital side about a potential loophole in our capital control arrangements in the run up to the introduction of the new capital regime in 1990. Local authorities will have both the scope and incentive to use cash-backed capital receipts to finance non-prescribed expenditure on certain types of repair and maintenance and to replace revenue contributions to capital. This could lead to higher expenditure both on repair and maintenance and elsewhere. Without early close down this too could lead to substantial claims of grant from the Exchequer.

The Chief Secretary initially suggested that the transitional arrangements in the capital consultation document should be altered to prevent or discourage rundown of the cash-backed receipts before 1990. We have now agreed that the best way to deal with the problem would be to use existing legislation to



limit local authorities' use of capital receipts after 1 April 1989 to finance prescribed spending and debt repayment. But the Chief Secretary and I are agreed that no action can be taken now and we should consider this further in the autumn. Meanwhile we agree that we should publish the capital consultation paper in its agreed form next week, simultaneously with our proposal on Rate Support Grants.

### Timetable

If we are to act on the grant side we must do so quickly. This will reduce the chance of local authorities getting wind of our proposal and acting to circumvent it. We therefore propose to proceed as follows:

- i. you may wish to discuss this with us early next week;
- ii. subject to your agreement, I will ask Cabinet Office to arrange a meeting of E(LA) on Wednesday 6 July to brief colleagues and conclude the main elements of the Settlement as usual;
- iii. seek Cabinet agreement to the package on 7 July; and
- iv. announce details to the House the afternoon of 7 July.

I have discussed this with Peter Walker.

I am copying this letter and enclosure only to Nigel Lawson, Cecil Parkinson, John Major, John Wakeham, Peter Walker, Malcolm Rifkind, Patrick Mayhew and Sir Robin Butler.

*R. Bigler*

NR  
1 July 1988

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

CHANGES TO THE LOCAL GOVERNMENT FINANCE SYSTEM  
IMPLICATIONS FOR GRANT AND EXPENDITURE

1. The 1989/90 Rate Support Grant (RSG) Settlement is the last under the present system prior to the introduction of the community charge in 1990. The central feature of the present system is that a local authority's grant entitlement varies with its expenditure. For almost all authorities higher expenditure means lower grant. From 1990 onwards, however, grant entitlement will be fixed at the beginning of the year and will not vary with expenditure; strong downward pressure on expenditure will, however, continue to exist since all additional expenditure will fall to be met by community chargepayers.

2. The change to the new grant arrangements gives local authorities an opportunity to reduce reported expenditure in the last years of the present system and thereby increase grant entitlements. In 1990 the capital control system will also be revised. This too will provide opportunities to local authorities to manipulate total expenditure to increase grant. Some reductions in expenditure will be genuine and rightly should lead to higher grant receipts. Others will be bookkeeping adjustments - such as use of special funds - that we have accepted recently should reasonably lead to additional grant. But some adjustments will be more dubious simply taking advantage of this unique opportunity to increase grant.

3. While authorities may be using these opportunities to reduce their "total" expenditure (total expenditure is the term of art for the measure of expenditure on which RSG is paid) and gain grants, they may alternatively increase their real underlying level of expenditure without foregoing grant, or strike some balance between the two. This note considers the risks of higher grant claims or higher expenditure and discusses options for reducing them.

## ASSESSMENT OF RISK

## (1) GRANT

4. Since 1987/88 the amount of RSG available to local authorities has been "open ended" i.e. dependent only on authorities' own expenditure decisions - the less they spend, the more grant is paid. The expectation, however, has been that the actual payments would be lower than allowed for in the RSG Settlements. In practice local authorities have indeed spent higher than allowed for in the RSG Settlements and have forfeited grant. On present information in 1987/88 authorities overspent by £811m and consequently lost £298m grant, while in 1988/89 authorities have budgeted to spend £1035m more than allowed for in the settlement and have lost £521m grant.

5. In the normal cycle of events we update our information after the year end to take account of first "unaudited" and subsequently "audited" out-turn and revise grant claims accordingly. Final calculations of grant are not made until at least two years after the end of the relevant financial year.

6. The particular grant risk to the Exchequer arises now because of the opportunity for local authorities to use accounting adjustments either to reduce reported total expenditure or to switch reported total expenditure from years in which it would reduce their grant entitlements to years where it has less impact on grant.

7. Throughout the 1980s local authorities have used a number of devices for reducing reported total expenditure in order to maximise grant. Common methods have been through the use of special funds, and by classifying expenditure on repairs and renewals as capital rather than revenue. Many rate capped authorities have indulged in a wider range of creative accounting arrangements.

8. We already know that many local authorities are wondering how best to take advantage of the opportunity presented by the change of system; and we believe that experts in the City are working up schemes to sell to local



authorities. Amongst the arrangements being considered are factoring - which involves "selling" future expected capital receipts - use of special funds, capitalising repair and maintenance, and reducing debt servicing costs.

9. We can anticipate the use of some of these schemes and take account of them in fixing the assumptions for the 1989/90 Settlement. In particular we can allow for use of special funds to reduce expenditure in 1989/90 and partly for further capitalisation of repairs and maintenance. We may also be able to prevent some abuses - such as factoring - using existing powers. But we cannot allow for other unwelcome accounting practices in the 1989/90 Settlement without effectively condoning them and thereby encouraging authorities to indulge them. Nor can we now change the assumptions for 1987/88 or 1988/89 which are the other years at risk of grant manipulation. Moreover it is always possible there may turn out to be other devices available to authorities to manipulate grant which we have not yet identified.

10. We cannot quantify precisely the extent to which Exchequer grant may be at risk. As an outer limit we note that in recent years rate capped authorities have understated true expenditure by around 12%. If all authorities were to understate expenditure to this extent the grant claim would rise by around £1700m in 1989/90. This certainly exaggerates greatly the extent to which grant might be manipulated. But we can expect manipulation even from authorities that would normally avoid such arrangements. In particular we can expect a herd instinct to develop as it becomes clear that many authorities are manipulating the system particularly as these accounting arrangements are all within the law. The risk to the Exchequer is at least £350m in respect of 1987/88 and 1988/89. For 1989/90 an expected grant underclaim of several hundred million pounds could become a grant overclaim. Moreover the proposed changes to the capital control system, which requires at least half of cash-backed capital receipts to be applied to redemption of debt in 1990, may encourage local authorities to make maximum use of capital receipts to reduce revenue expenditure, and hence gain grant, in the years up to 1989/90. Annex A sets out our present assessment of the maximum scope for manipulation by those means we have been able to identify.

## (2) EXPENDITURE

11. Another risk is that the period of transition to the new control system will see a surge in overall spending by local authorities. There are three main ways in which this might come about.

12. First, the more grant the authorities succeed in obtaining from the Government, the more possible it will be for them to finance extra expenditure without additional calls on the domestic ratepayer. However, to the extent that authorities raise revenue spending in 1989/90 they will, under present rules, forego grant gains.

13. Second, the action which the Government takes to prevent local authorities from obtaining large extra amounts of grant on the strength of creative accounting could have the effect of reducing the marginal impact of extra spending on domestic ratepayers to a level far below that under the existing control system or the Community Charge system. This would reinforce the temptation which authorities may anyway perceive to spend more during the next 18 months when they will be able for the last time to raise extra sums from non-domestic ratepayers.

14. Third, some authorities may be prompted to undertake extra expenditure as a result of publication of details of the transition to the new capital control system. Although most capital expenditure by local authorities is "prescribed expenditure" and thus subject to control under Part VIII of the Local Government, Planning and Land Act 1980, there is also a considerable amount of "non-prescribed" expenditure. The largest element of such expenditure (about £500m a year) is capitalised repair and maintenance of buildings, roads, and structures. The amount of capitalisation has increased in recent years, largely in response to pressures to maximise grant and keep rates down. The 1980 Act limits the rate at which local authorities may use their capital receipts to finance prescribed expenditure and, at present, there are approximately £6½ billion of cash-backed capital receipts (of which £0.4bn are held by counties, £0.6bn by metropolitan districts, £1.2bn by London authorities, and £4.2bn by shire districts).

15. Under the new capital control system, local authorities will be required to apply a proportion of their cash-backed capital receipts to debt redemption. (The proportions at present envisaged are 75% for the proceeds of council house sales and 50% for other receipts). In terms of their ability to use capital receipts to finance capital expenditure, they will "lose" this amount and the Treasury's first concern is that this may provide an incentive to them to "use" their capital receipts in the interim to undertake extra capitalised repair and maintenance expenditure.

16. Quite apart from this, and leaving aside the question of RSG incentives to capitalisation, the Treasury's second concern is that the prospect of the new system may also provide an additional incentive to local authorities to transfer expenditure that they would otherwise have incurred on repair and maintenance from revenue to capital account. That would not represent additional expenditure, and would probably be accomplished by ex post facto bookkeeping adjustments, but would have the effect of converting a corresponding amount of capital receipts into revenue balances, which would be available to finance further expenditure rather than be applied (in part) to debt redemption.

17. There are a number of constraints or disincentives which will in practice limit the use of capital receipts (either to finance extra expenditure or to transfer expenditure out of revenue account) :-

- i) Not all repair and maintenance expenditure can properly be capitalised. (works which will lengthen the lives of assets or save expenditure in several future accounting periods may qualify - day-to-day repairs do not);
- ii) Although the sums available for capitalisation are significant there is a marked "mismatch" between the distribution of capital receipts (primarily in shire districts) and the distribution of the sort of structural maintenance that can properly be capitalised. (Some of the authorities who have latterly made extensive use of capitalisation have now used up their capital receipts);

iii) To the extent that capital receipts are spent before the new capital control system comes into effect, the amount of capital spending power which local authorities will derive in the new system from capital receipts will be reduced. (For any given level of capital receipts, the new system will, by comparison with the present system, give local authorities greater freedom to spend a smaller overall amount. But it will permit a larger proportion to be spent in any given year). Thus to use capital receipts for extra maintenance will make it more difficult to undertake future large projects.

iv) Depending on the choice made between options G1 and G2 below, the present strong grant incentive to capitalisation may be removed.

18. DoE's assessment is that the amount of additional repair and expenditure which might be undertaken as a result of knowledge of the proposals for the new capital control system would not exceed £200m in 1989/90. (This figure is an upper bound, not an estimate). The overall scope for capitalisation by bookkeeping adjustments might be as much as £1000m over the 3 years 1987-88, 1988-89 and 1989-90.

#### OPTIONS FOR REDUCING RISK

19. This section considers what action might be taken to reduce these risks. There are 2 grant options (G1 and G2) and two options on capital receipts (C1 and C2). Doing nothing is also an option in both cases.

20. In considering what might be done we have taken account of the situation regarding determination of grant for the forthcoming year after the next RSG Settlement, the present year (1988/89) and, past years. Grant entitlements for 1988/89 and all outstanding earlier years are due to be revised in Supplementary Reports later this year. These reports will take account of outturn expenditure for 1985/86 and 1986/87, of revised budgets for 1987/88 and budgets for 1988/89. Full sets of expenditure data for these Supplementary Reports are being put together now. This therefore provides a

good opportunity for changing the present system to reduce the risk to the Exchequer. The next such opportunity when we will have full sets of expenditure data for all outstanding years is July 1989.

21. We have identified two main options for reducing the opportunities to manipulate the system to increase grant claims. The first requires legislation in the next session to change the basis on which grant will be distributed in 1989/90, and to limit grant claims in respect of earlier years. The second option is to delay action until summer 1989 and then legislate to close down the present system.

OPTION G1 : Immediate closedown of the present RSG system

22. The main features of this proposal are: -

(a) grant entitlements for 1989/90 would be fixed in the forthcoming settlement and would not be linked to actual expenditure. This means that there would be no grant underclaim as in 1987/88 and 1988/89, but nor would there be any risk of grant overclaim.

(b) Final grant entitlements for 1988/89 and all outstanding earlier years would be determined on the basis of reported expenditure available on the date of the announcement in July of this year (possibly with a small adjustment reflecting the normal average reduction in expenditure from budget to outturn). These grant changes would be made through supplementary reports at around the end of this year : these would be the last reports under the present system.

23. Fixing grant in this way would remove the risks to the Exchequer on the grant side. But it would also reduce pressure on local authority expenditure since higher expenditure would no longer lead to lower grant. We do not know what effect there would be on expenditure in this transitional period before the discipline of the community charge system is introduced. But every 1% increase in expenditure is equivalent to £300m. Account would have to be taken of such grant and expenditure implications when determining the 1989/90 RSG Settlement.

24. If this option is pursued an early announcement is desirable to minimise both the risk to the Exchequer and the possibility of authorities getting wind of the proposal and adjusting the accounts before we act. A short Money Bill would be required in the autumn to achieve Royal assent by March in order to pay grant in 1989/90 on the correct basis. Apart from this the 1989/90 Settlement and the series of supplementary reports planned for the autumn would proceed as planned other than that no account would be taken of expenditure data reported to us after the date of announcement.

**Option G2: Delay closing down until 1989.**

25. Under this option the existing grant related restraints on expenditure would continue. For most individual authorities, higher expenditure would continue to mean absolute reductions in grant. The option consists of three elements:

(a) run the system for another year and announce close-down arrangements in July 1989. At that time we would have information on expenditure for all outstanding years of the present system. The legislation would simply state that for the purposes of calculating grant entitlements no account would be taken of later information expenditure in respect of any year. If at that time the scope for manipulation seems much reduced, it might even be possible to give authorities advance notice of closedown in respect of certain financial arrangements.

This element alone would carry a significant risk of grant manipulation in 1989/90. It would therefore also be necessary:

(b) to draw up a "tough" 1989/90 RSG Settlement to allow as far as possible for potential manipulation in deciding upon the spending assumptions and the grant total; and

(c) to take separate action to block off other manipulations of the system to the greatest possible extent. Action on capitalisation of repairs, etc. (Option C2 below) would certainly be necessary. Other

action, to prevent the use of other devices that come to light, would have to be taken as necessary if and when their significance or potential significance came to light.

26. The option on capital receipts is:-

**OPTION C1 and C2 : Bring Capitalisation of Repairs under control.**

The use of receipts to finance capitalised repair and maintenance expenditure is theoretically under the control of the Secretary of State, though that control has for many years now been waived by means of the issue of general consents and block borrowing approvals. Under the option, these consents would be modified so as

- (i) to preclude or limit the use of capital receipts for this purpose; or
- (ii) to require specific consents to be obtained; or
- (iii) to permit the use of receipts only for specified classes of expenditure.

There are limitations on the scope for changing the rules during a financial year, and in particular for changing them with immediate effect. This is because (a) changes cannot be made retrospectively in the absence of primary legislation and (b) it is only at the end of year, when the accounts are drawn up, that particular sources of finance are imputed to the particular items of expenditure. So to the extent that permission to use receipts for any given class of transactions is withdrawn during the year, the local authority could when drawing up their accounts impute receipts to all transactions in that class before the relevant date and other sources of finance to transactions after that date.

27. In DOE's view, it is not practicable to think of altering the rules for 1988-89 so as to impose restrictions on the use of receipts to finance actual repair and maintenance during that year. It would, however, be possible to prevent local authorities from entering into advance maintenance deals (on the lines of the advanced purchase deals for capital expenditure which were

brought into control by the Local Government Act 1987). This is because there is no evidence that authorities have yet started to enter into such deals. The immediate prohibition of advance maintenance deals in Option C1.

28. It would in DOE's view be practicable to impose a more rigorous control for 1989-90. It would be necessary for consultation to be undertaken and for the consents to be modified before the end of 1988-89 so that the modification took effect from 1 April 1989 and so that authorities could allow for this when setting rates. The modification would have to be accompanied (if this had not already been done) by action in relation to advance maintenance deals. This is Option C2.

29. Option C2 would be controversial and would be represented as being inconsistent with undertakings that Ministers have given about the ability of authorities to use capital receipts to finance repair and maintenance work and the encouragement that authorities have been given to do this in the field of housing. It would have to be justified on the basis that action was needed to prevent excessive expenditure in this area financed by capital receipts or the use of receipts to liberate revenue spending power. Option C1 would be much less controversial.

#### ASSESSMENT OF OPTIONS

30. Option G1 provides the greater certainty on grant as Treasury would know exactly how much grant has to be paid out under the present grant system up to March 1990. The change could be presented as an orderly transition to the new system where grant will also be fixed in the Settlement. By acting swiftly we minimise the risk to the Exchequer. Local authorities would also know precisely how much grant they would be entitled to and could concentrate on setting up the new system rather than expending energy trying to manipulate the present system.

31. The first option has four main disadvantages. The first is that there would be less downward pressure on local authorities' total expenditure following the July announcement. This could lead to higher local authority expenditure in the period to March 1990. A 1% increase, as noted earlier, is £300 million. DOE doubt whether the reduced disincentive to spend more at the margin would greatly affect the overall level of expenditure. In the



Treasury's view these marginal effects do influence behaviour. Under Option 1, an average authority would have to finance some 45% of any increase in expenditure from the domestic rate-payer, as against some 73% under option 2 and 100% under the community charge.

32. A second, related disadvantage is the loss of grant underclaim in 1989-90. The present estimates of underclaim in 1987/88 and 1988/89 are about £300m and £500m respectively. This needs to be set against the savings in grant from closing off the possibilities for manipulating accounts so as to increase grant entitlement.

33. A third disadvantage is that the Government would have to expect strident criticism from local authorities for changing the rules in mid game. Authorities who genuinely reduce their expenditure below present reported levels for 1987/88 and 1988/89, and below the 1989/90 settlement spending assumption would receive no reward. Further, authorities who have legally built up special funds would resent action by the Government to remove the grant entitlements which they assumed they would have on drawing down those funds. The Government would come under pressure during passage of the Bill to concede that authorities may enjoy the grant advantages of special funds: no [significant] concession would be possible, however, without destroying the whole approach.

34. Finally, option 1 would require a short but highly contentious money Bill in the 1988-89 Parliamentary session, where the pressures on time already promise to be intense.

35. Option G2 would have the advantages of retaining the grant-related restraints on total expenditure in 1989-90, at least until the authorities have set their budgets. There would also still be a grant underclaim in 1989-90 associated with decisions by local authorities to spend in excess of the settlement spending assumptions. And this option avoids legislation in the 1988-89 session and the opportunity that would provide for complaint and concessions.

36. This option also has several disadvantages. The main one is that between now and next summer the Government would have to be ready to meet

large claims for extra grant in respect of 1987/88 and 1988/89, and in respect of 1989/90 to the extent that the settlement did not allow for all opportunities to reduce expenditure and increase grant.

37. The second disadvantage is that at any time local authorities might bring forward new schemes to increase grant entitlements. We would either have to live with the grant consequences or stand ready to block such loopholes through further legislation. Most likely these would entail "midnight tonight" elements.

38. Thirdly we would expect a rolling barrage of criticism both any administrative and legislative changes necessary to block off loopholes, and about the toughness of the RSG Settlement. On the Settlement we would face particular criticism over assumptions that effectively required authorities to indulge in "creative accounting" arrangements such as capitalisation of which many would heartily disapprove.

39. Finally Option G2 would require a Money Bill in the 1989/90 legislative session, where pressures on time are also likely to be considerable.

40. It should also be noted that although this option would allow authorities with special funds to gain the grant benefits other authorities would receive correspondingly less grant within a given grant pool. The grant distribution in 1989/90 might therefore be very skewed leaving some authorities well placed for the introduction of the community charge but others poorly placed.

41. Options C2 will prevent exploitation of the freedom to capitalise repairs and renewals in 1989/90. If no action is taken authorities might at the outer limit be able to fund up to £500m of additional expenditure on repair and maintenance or elsewhere in their programmes through capital receipts. Action to prevent this would be badly received by local government (see para 28 above) even if the approach is modified e.g. to allow capitalisation on the level of recent years. Furthermore, authorities have to know what is proposed before they set their rates for 1989/90, but this fore-knowledge will give them an opportunity to maximise capitalisation in

1987/88 and 1988/89. This option cannot therefore be wholly effective. Option C1 would be less controversial and would operate successfully on one aspects of the problem. Neither of these options would require legislation.

42. Either Option G1 or G2 can be combined with Option C1, or Option C2. Option G1 (RSG Closedown in July 1988) would remove the grant incentives to undertake capitalisation and to that extent, but to that extent only, would make Options C1 and C2 less necessary. A combination of Option C2 and Option G2 would be an effective approach to 1989/90 provided allowance was made for potential manipulation in framing the 1989/90 Settlement, but this combination of a pre-emptive Settlement and the announcement of Option C2 might well lead authorities to maximise the opportunities still open to them in 1987/88 and 1988/89. Option C1 would, however, shut off one avenue of manipulation completely.

## ANNEX A

Scope for Manipulating Total Expenditure In Order To Gain Grant

N.B. These figures are estimates of the maximum potential use of the various devices. We have no evidence that they will be used on this scale.

	Maximum grant at risk £m
Special Funds : £1.1bn of special funds available at April 1989. Use of up to £900m could be allowed for in 1989/90 settlement. Remaining £200m could be used in earlier years to increase grant claims by around £200m	200
Capitalisation of repairs and renewals: LAs have around £7bn of cash backed capital receipts that could in principle be used to finance repairs and renewals. In practice the scope is much lower as around £5bn receipts are held by shire districts. But as much as £1bn could be used between 1987/88 and 1989/90 to reduce total expenditure thereby increasing grant claims by £500m.	500
Factoring : This scheme is specifically designed to reduce total expenditure and increase grant. It involves "selling future capital receipts" for a lump sum which is then invested. The resultant interest receipts count as a reduction to total expenditure and hence increase grant. The future capital receipts are "repurchased" post March 1990. One London Borough is already planning to increase RSG entitlements by £½m in both 1988/89 and 1989/90 through this arrangement. The total RSG at risk in 1988/89 is probably small but in 1989/90 could in principle be up to £100m. Consideration is being given to ways of stopping this abuse of the system.	100
Debt Servicing: LAs could reduce repayments of outstanding debt from the revenue account by shifting the profile of repayments or by early repayment of outstanding debt from capital receipts. At risk here is up to £200m of expenditure and hence around £100m of grant for the period up to March 1990.	350

Short term delaying of expenditure :

There is scope for authorities to holdback expenditure from the early part of 1990 and have a surge of expenditure in April 1990. We have seen evidence of this when targets and holdback were abolished in 1986. Perhaps 2% of expenditure might be so delayed. This would increase grant claims by around £300m.

300

Interest rate swaps :

This involves swapping a low interest loan for a higher interest loan with an outside body for an up front premium. This premium is then invested and the interest receipts used to reduce total expenditure. Although the amounts swapped are large the effect on total expenditure is relatively small.

- ?

Other schemes : We know of a number of other small scale schemes for reducing total expenditure. We cannot rule out however that new large scale schemes may be devised.

- ?

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*pp*

FROM: R FELLGETT  
DATE: 1 JULY 1988

CHIEF SECRETARY

cc Chancellor ←  
Sir P Middleton  
Mr Anson  
Mr Edwards  
Mr Potter

RSG 1989-90 AND CAPITAL RECEIPTS

The Prime Minister will take a meeting at 11.30 on Monday morning to discuss Mr Ridley's minute of today. - *below*

2. At that meeting you will wish to :

i. support Mr Ridley's case that urgent closedown is needed, in view of the risks to the Exchequer (which amount in all in the ~~most~~ <sup>worst</sup> possible case to some £1.2 billion) identified in the paper by DOE and listed at Annex A to that paper;

ii. convince the Prime Minister that an announcement needs to be made as soon as Thursday 7 July - a few key points to make are at A attached;

iii. convince her and the business managers that, regrettably, there is no choice but to take a short money Bill - see B attached;

*Mr Ridley is going to ring Mr Whitehead over the w/e.*

iv. obtain the firm endorsement of the meeting for the AEG quantum of £13575 million you have agreed with Mr Ridley - see C attached.

3. The meeting should also note that the capital consultation paper should issue as originally agreed, also on 7 July.

4. Cabinet Office are provisionally arranging a meeting of E(LA) on Wednesday 6 July, to discuss all this with colleagues if the Prime Minister and others agree to go ahead. We have established today that Mr Ridley cannot announce AEG on Thursday

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without simultaneously announcing provision, for legal reasons. And also for legal reasons, he cannot announce provision without announcing rate capping. The E(LA) meeting will therefore have to agree provision, however long that takes, and resolve any differences of view on rate capping; so far as we are aware the only dispute may be over the precise Expenditure Level for ILEA.

5. I understand that Mr Ridley spoke to Mr Walker this morning. DOE officials and I subsequently briefed Welsh Office officials. They were inclined to recognise that Wales would have to follow England, and close down with a fixed grant settlement. They are also keen to issue the capital consultation paper on Thursday. But their initial view was that Mr Walker would be looking for a quantum of AEG involving a bigger rise for Wales than for England, ie more in Wales than 4% plus a substantial contribution towards Community Charge preparation costs. They will quantify their arguments, but I am not convinced that there is any justification for a more generous increase in Wales; Mr Ridley may have enough difficulty making his statement without Mr Walker (or Mr Roberts, as Mr Walker is in Russia all next week) making the English settlement look mean by comparison.

6. I suggest that you say on Monday that the Welsh RSG system must be closed down simultaneously with England. Otherwise invidious comparisons would be made between the treatment of neighbouring counties in the Marches. If the quantum of AEG for Wales is raised at the PM's meeting you might get a very quick agreement to the same percentage uplift as in England. If not, you may need to discuss it with a Welsh Minister during Tuesday.

7. I understand that you asked for a list of the legislative measures that might be needed if we do not close down. We will forward this during Monday morning.

*Robin Fellgett*

R FELLGETT

**A. 7 July unavoidable now:**

- Capital receipts issue already leaking; Guardian of first July has headline "Treasury holds up Council Cash plan"; if councils get wind of closedown they could send in information about alleged lower expenditure and claim hundreds of millions of unjustified additional Exchequer grant.
- Cannot again cancel E(LA) when colleagues believe so little progress has been made on the RSG settlement which should be announced this month; if it is cancelled again colleagues will know that something is a foot and so will their departmental officials; grave risk of the news leaking.

**B. Additional Bill in the 1988-89 session necessary:**

- Highly regrettable, and looked carefully at ways of avoiding another Bill.
- Cannot add clauses to the Local Government and Housing Bill, which will not receive Royal Assent until well after the start of the 1989-90 financial year. New powers are needed to pay grant on the new basis before the start of the next financial year.
- Bill should be a very short money Bill; best not take this issue through the Lords.
- The alternative to action along the lines proposed could be a series of "midnight to night" announcements and legislative measures to block creative accounting to manipulate additional Exchequer grant. [Possible details to follow.]



**C. Stick to £13575 million as agreed and not a penny more.**

- Agreed with Environment Secretary (see his minute), subject to endorsement of colleagues in E(LA) on Wednesday and Cabinet on Thursday.
- Although closedown proposal is best available option, remain concerned about potential additional expenditure by local authorities in 1989-90. Agreed quantum of grant represents an increase at settlement of 4% plus £80 million to substantially finance Community Charge preparation costs. Any more would encourage higher local authority public expenditure.
- £13575 million represents £1.1 billion (9%) more than grant actually paid in current year (after holdback) - generous increase already.
- According to DOE estimates, rates rises in 1989-90 forecast to be five and a half percent on average, and six and a half percent for non-rate capped authorities. Actually less than in 1988-89, and no reason to try to push them lower still to make the rates popular again in their last year.

CONFIDENTIAL

CHIEF SECRETARY

FROM: B H POTTER

Date: 1 July 1988

cc: PS/Chancellor  
Sir Peter Middleton  
Mr Anson  
Mr Phillips  
Mrs Case  
Mr Edwards  
Mr Turnbull  
Mr Revolta  
Mr Farthing  
Mr Williams  
Mr Kelly  
Mr Fellgett  
Mr Call

## RATE CAPPING 1989-90

We have agreed with Cabinet Office that it would now be best to handle rate capping in correspondence. Accordingly this submission covers the following proposals on rate limitation in 1989-90:

- that seven general purpose authorities should be capped (the Environment Secretary's paper E(LA)(88)3 refers)
- that no passenger transport authorities (PTA) should be selected (Transport Secretary's letter of 16 June);
- that no joint police or fire and civil defence authorities (FCDAs) should be rate capped: (Home Secretary's letter of 21 June); and
- that ILEA should be rate capped (Education Secretary's letter of 16 June).

2. I recommend that you agree to all the above proposals. I also suggest that you agree to the Expenditure Levels (ELs) proposed for the seven general purpose authorities but reply separately on the question of the EL for ILEA.

### The General Purpose Authorities

3. Under the Rates Act 1984 the Environment Secretary can select for rate limitation any local authority whose expenditure is deemed excessive. Section 2 of the Act requires that excessive must be measured in terms of total expenditure as defined in Part 6 of the 1980 Act. In practice the criteria for selection refers to threshold set on absolute levels of total expenditure and year on year growth. Each authority selected is given a maximum expenditure level (EL) again defined in terms of total expenditure, to which the rate cap is linked.

4. But creative accounting gives scope both for avoiding selection - by manipulating reported total expenditure so that it is below the thresholds - and exceeding the EL.

5. For 1989-90, Mr Ridley proposes that a single selection threshold on total expenditure - GRE + 12½% as this year - should be set. On this basis seven authorities would be selected. We agree with DOE officials assessment that this year the reduction in the number of authorities selected from 17 to the proposed 7 reflects some progress this year in underlying current expenditure. But it is due in greater part to their skill at creative accounting games. Nine of the ten which have escaped the threat of rate capping next year by getting their expenditure under the critical GRE + 12½% threshold, are still spending in underlying expenditure terms well over the GRE + 12½%. And ideally we would have wished to rate cap these. But DOE have taken legal advice that any attempt to tighten the criteria could well be the subject of legal challenge. And, as it happens, even if the legal advice had allowed us to go for a tigher limit at the theoretical maximum of GRE + 10% (that is the point at which the slope of the grant schedule becomes steeper), we would only have captured one further authority and even then only just.

6. We conclude there is no scope to reselect any more than seven of the seventeen authorities selected last year. In principle we could seek to cap other authorities next year not selected in 1988-89. In the past, two criteria have been applied for selecting new authorities in any year ie those not selected in the previous year. If we applied only one for 1989-90 - the same as for those previous selected - a further four authorities - the City of London, Blackburn, Bristol and Leicester - have set budgets for 1988-89 above the selection threshold. But we cannot select the other three without including the City.

7. Given the legal advice the choice lies between the seven authorities proposed by Mr Ridley or taking in the extra four identified in the preceding paragraph. The position is unsatisfactory: but it would be quite impossible to persuade Mr Ridley to take the legislative action necessary to change the basis of the selection criteria ie total expenditure in order to capture any further authorities this year. Nor will he wish to rate cap the City. I recommend that you accept Mr Ridley's proposals.

#### Other authorities

8. Following abolition of the metropolitan counties and the GLC, certain joint boards and single purpose authorities then formed were automatically subject to precept limitation for the years 1986-87, 1987-88 and 1988-89. Now, like the general purpose authorities can only be rate capped if they meet the general criterion for rate limitation.

#### (a) Passenger Transport Authorities.

9. It had been expected that selection would be possible in 1989-90 for some PTAs. Three of them had budgets above GRE + 12½% threshold this year. But these expectations have been upset by recent legal advice to the effect that the Secretary of State can only limit PTAs precepts in 1989-90, if he had made it clear

*Ridley*

- when setting their expenditure levels for this year - that such expenditure was still excessive, or if there had been a substantial change of circumstances since then. Neither of these conditions hold and Mr Channon is not willing to take the risk of legal challenge.

10. The loss of precept limitation powers over PTAs is not in itself a major setback. DTp would have been prepared to permit expenditure increases in line with inflation. In the absence of controls expenditure will go up by more than that but probably not dramatically so. PTAs are not geared up to make large increases. Under the deregulated bus regime increasing subsidies is not a simple procedure and it requires a tendering exercise for each subsidised route. PTAs do expect to be precept limited if they generally increase their expenditure. HE's advice is that we should not oppose Mr Channon's proposals.

(b) Joint police and FCDAs.

11. Because of the legal advice given, it seems that none of the joint police authorities or FCDAs could be regarded as having spent excessively in terms of the 1984 Act either. Home Office have never argued that the spending of their joint bodies was excessive. Indeed in introducing precept limitation in 1986, the Home Secretary said that this was taking place not because he thought there was serious overspending by the authorities but to prevent the creation of extravagant and expensive bureaucracies. The Home Office have maintained the line every since.

12. None of the joint police authorities is spending more than 12½% above GREs and could not be selected in any case. But spending by some FDCAs is well above their GREs and applying the common threshold would mean they ought to have been selected. Nonetheless, subject to the comments made about the presentation below, in view of the Home Secretary's failure to describe their ELs as excessive in the past and given the legal advice, again we have to accept that no FDCAs can be capped.

(c) ILEA

13. Mr Baker is content that ILEA should be rate capped. Fortunately he has made it quite clear in the past that he regards their existing ELs as excessive; each year's EL has been presented as steps downwards towards to an acceptable level of spending.

#### Presentation

*True*  
14. To sum up therefore it is proposed that the seven general purpose authorities and ILEA should be rate capped in 1989-90. But there is a potential problem of presentation. Under the provisions of the Rates Act 1984, the Environment Secretary is not required to explain why an authority has not been selected. But the fact that a number of PTAs and FCDAs with spending above the GRE + 12½% threshold applied to other authorities have escaped from precept limitation, might be used by ILEA to challenge its own selection. In ILEA's case as already noted Mr Baker did say that expenditure was still excessive when he set the 1988-89 EL so the legal grounds for limiting the precept in 1989-90 are present. But the danger comes from what might be said by DTP or Home Office Ministers or officials in justifying the absence of precept limits. If critics point to the fact that for example some PTAs have expenditure more than 12½% above GRE, it is essential that DTP should not say that public transport GREs are unreliable (which they are): exactly the same argument could be applied to ILEA and indeed to the general purpose authorities.

15. DTP officials have assured us that they do not intend to deprecate public transport GREs publicly and that they are prepared to justify the absence of precept limitation for PTAs in whatever way will limit the repercussions most effectively. This means relating the decision to the specific circumstances of the PTAs. The formula used by Mr Channon when he announced the 1988-89 ELs - that they ensured a reasonable balance between the needs both of ratepayers and the public transport users would be acceptable. But some similar form of words will need to apply to Home Office and the decision not to select the FCDAs. This is an important point and will have to be pursued by officials.

Longer term considerations

16. As you are aware we are taking steps to tighten the capping regime under the Community Charge 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;

(ii) the system will allow DOE to take into account all sources of local authority finance ie including the likely use of creative accounting.

17. So we ought to be able to avoid the kind of creative accounting that has so limited the freedom of action this year. It is worthwhile drawing attention to the improved arrangements for next year and to warn colleagues now that we may have to look for wide application of Community Charge capping to keep charges down to an acceptable level.

Expenditure Levels (ELs)

18. Finally, for the seven general purpose authorities Mr Ridley proposes that there should be a cash freeze on their expenditure levels. I recommend that you agree to this: it is in line with the practice for the previous two years. It is conceivable that Mr Moore may object that this will impose unacceptably low standards for personal social services provision. But following discussion at official level, I do not think he will be able to mount a serious challenge. I have agreed with HE2 Division that they will brief separately on the EL for ILEA.

19. I attach a draft letter for you to send to the Energy Secretary, as Chairman of the E(LA).

*Robi Fellgett*

pp BARRY H POTTER

DRAFT LETTER FOR SECRETARY OF STATE FOR ENERGY

RATE LIMITATION: 1989-90

Nicholas Ridley has circulated proposals for rate capping certain general purposes local authorities in 1989-90. I have also seen the letters from Douglas Hurd, Kenneth Baker and Paul Channon setting out proposals for those single and joint purpose authorities for which they have responsibility. Given that both Douglas Hurd and Paul Channon do not believe it would be practical to limit any of their authorities, we face the prospect of applying rate limits only on seven general purpose authorities and ILEA in 1989-90.

It may be helpful if I set out my views at this stage. I do not wholly share Nicholas' view that his proposal to select only seven general purpose authorities for rate capping this year is a vindication of the rate capping system. I accept that there has been some progress in reducing underlying current expenditure in one or two authorities. Indeed nine of the ten authorities which were rate capped this year cannot be rate capped next year because they have reduced their reported total expenditure below the GRE + 12½% threshold. That owes just as much to creative accounting used to drive a wedge between their reported



total expenditure and actual underlying current spending than to any genuine reduction in spending. In many of these authorities underlying expenditure remains unacceptably high.

Nonetheless I appreciate that the selection criterion to be applied to authorities previously rate limited in this year cannot safely be tightened further in the view of the legal advice given earlier; and there can be no question of taking more vigorous action in the last year of the present scheme to change the basis of selection from the unsatisfactory concept of total expenditure in order to bring more authorities within the net. I am therefore reluctantly prepared to agree that only the seven general purpose authorities identified by Nicholas should be rate capped in 1989-90.

Our scope for selecting both passenger transport authorities (PTAs) and joint fire and civil defence authorities (FCDAs) also seems to be fettered by legal advice that we have been given. Because we have indicated that Expenditure Levels (ELs) for the present year for the PTAs represent a reasonable balance between the interests of the ratepayer and the transport user, I can well understand why lawyers advise that those same ELs cannot now be deemed excessive in the terms required under the 1984 Rates Act in order to justify

selection for rate-capping next year. This is to say the least unfortunate and I fear that one or two of these authorities may take the opportunity, while they have escaped from the net, to increase their spending and the precepts they make upon local ratepayers. But again I am reluctantly forced to accept that there is little we can do but accept that no joint police, FCDS and PTAs can be rate capped next year.

I agree with Kenneth Baker that ILEA must be rate capped next year.

I will write separately shortly on what the EL for ILEA might be. I am content with Nicholas' proposal to set ELs for 1989-90 for the general purpose authorities as a cash freeze on their 1988-89 ELs; I believe that represents an acceptable balance between maintaining the downward pressure on these authorities' expenditure, while avoiding requiring excessive cuts in the level of services.

I am concerned at how we present the overall picture which emerges of only seven general purpose authorities and only one other authority - ILEA - being subject to rate limitation next year. I accept that the Environment Secretary is not required under the terms of the Act to explain why an authority has not been

selected. Yet I do not suppose it will take long for ILEA and perhaps one or two other authorities to question why PTAs and FDCAs whose expenditure exceeds the GRE + 12½% criterion proposed for selection this year have not in fact been selected. I think it is crucial that we present our defence in terms of the ELs for both the FDCAs and PTAs for this year as having been reasonable rather than excessive. What must not be done is to imply in any way that the failure to select these authorities is some kind of reflection upon the accuracy of their GREs. That would be a particularly dangerous line to follow: it could prejudice our ability not only to rate cap ILEA but also some of the general purpose authorities. I suggest that DOE, DTp, Home Office, DES and Treasury officials should agree on how the rate limitation proposals should be presented.

Finally I think there is an important wider lesson to be drawn from this year's experience. In 1989-90 we now face the prospect of capping only a very small number of authorities. Moreover all authorities will know that, because of the change in the capping arrangements from the present year arrangement which operates on the preceding year's budget to the new in-year control system, authorities can spend up in 1989-90 with no danger of being capped as a result. In the circumstances there is a danger of a surge

in expenditure and we will therefore need to give careful consideration to our precise proposals for Community Charge capping. It will be important to retain the maximum flexibility to apply Community Charge capping on as wide a basis as seems desirable in the light of the budgets and Community Charge proposals produced by authorities in 1990.

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

SECRET AND PERSONAL

pyp

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COPY NO 2 OF 9 COPIES

Treasury Chambers, Parliament Street, SW1P 3AG

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

CX  
 Sir P Middleton  
 Mr Anson,  
 Mr Phillips  
 Mr Edwards  
 Mr Potter  
 4 July 1988  
 Mr Fellgett  
 Mr Tyrrie

Dear Roger,

#### 1989-90 RSG SETTLEMENT/CAPITAL CONTROLS

Your Secretary of State, accompanied by the Minister for Local Government, Mr Osborn, Mr Parker and Mr Roberts discussed this again with the Chief Secretary on 30 June. Also present were Mr Edwards, Mr Potter and Mr Fellgett from the Treasury.

Your Secretary of State opened by saying that he had not previously mentioned the question of what to do about the legitimate underspend on 1987-88 and 1988-89 budgets. DOE had estimated that this was conventionally around  $\frac{1}{2}$  per cent of budgets and that would mean a grant entitlement were normal grant mechanisms operating of £75 million a year. There was a question whether that should be compensated for either this year or in the next AEG settlement. He had looked at the figures proposed for grant and would be prepared to settle for AEG at the 1988-89 settlement level plus 4 per cent plus £110 million for Community Charge preparation. That gave grant of £13,600 million and was his bottom line.

The Chief Secretary noted that your Secretary of State had not mentioned the rate effects. On the DOE assumptions about drawings on balances of special funds and actual spending in 1989-90 the rate increases looked extremely modest; he would therefore be looking for a rather lower addition to AEG of £450 million. The previous day's discussion had been concerned

SECRET AND PERSONAL

to avoid rate increases approaching double figures. Grant as high as your Secretary of State proposing was clearly not necessary to do that.

The Minister for Local Government suggested that the DOE might be prepared to accept a slightly lower grant figure - of say £13,575 million - if the issue of amounts due in respect of 1987-88 and 1988-89 be settled separately. The Chief Secretary noted that the Treasury were foreswearing underclaim in 1989-90. Your Secretary of State said he envisaged the possibility of taking something out of the aggregate amount of grant agreed to meet claims for the earlier years. This could be less than £70 million. The Chief Secretary noted that the Minister for Local Government's proposal represented a substantial increase over the figure your Secretary of State had previously proposed. After some further discussion it was agreed that AEG to be paid in 1989-90 should be £13,575 million. Your Secretary of State would consider whether he wished to pay some part of that total in respect of earlier years. Your Secretary of State tended to feel that, with grant of £13,575 million it would be preferable to pay it all in respect of 1989-90.

Your Secretary of State agreed that it would be preferable to announce the grant quantum alongside Option 1 closedown and the capital controls document on 7 July. E(LA) would meet to discuss to settle provision. Your Secretary of State thought it should be possible to get agreement to a 4 per cent increase on budgets plus Community Charge preparation costs i.e. Option 2 in the paper he had put previously to E(LA). This would imply a grant percentage of 43.2 per cent in 1989-90.

The Chief Secretary noted that the agreement of the business managers to provide the necessary legislative time could not be taken for granted. There were severe pressures on the forthcoming legislative session. Mr Roberts that a 2 - 3 Clause Bill was all that was required although the legislation was undoubtedly controversial. Your Secretary of State said he would put a minute to the Prime Minister on Friday. He would speak to the Secretary of State for Wales. He would ask the Cabinet Office to arrange a meeting of E(LA) for the Wednesday before the possible announcement, with a view to seeking Cabinet's endorsement on the Thursday. The proposals would then of course be subject to consultation with local authorities in the usual way.

The Chief Secretary raised the issue of capital receipts. There was general agreement on Option C1, but it was also agreed that this should not be announced alongside the consultation document. Mr Parker said that DOE would be ready to move to stop advance maintenance as soon as it was perceived to become a problem. There was advantage in leaving action to the last minute. Your Secretary of State agreed to wait to see what happened on capitalisation of repairs and consider the action along the lines of C2 if necessary. The Option of taking account

SECRET AND PERSONAL

of the likely of non-prescribed expenditure in the Survey could be reviewed for the Survey in the light of local authorities' reaction to the Green Paper. The Chief Secretary said that his initial view was that the Survey option was not to be preferred. It was agreed that the minute to the Prime Minister should include a reference to the possible need for action on capital.

Yours,

*Jin*

JILL RUTTER  
Private Secretary



10 DOWNING STREET  
LONDON SW1A 2AA

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ACTION	
COPIES TO	

4 July 1988

From the Private Secretary

Dear Roger,

1989-90 RSG SETTLEMENT

The Prime Minister held a meeting earlier today to discuss your Secretary of State's minute of 1 July. Those present were: the Chancellor of the Exchequer, your Secretary of State, the Lord President of the Council, the Secretary of State for Energy, the Chief Secretary to the Treasury, Richard Wilson (Cabinet Office) and Peter Stredder (Policy Unit).

I should be grateful if you and copy recipients would ensure that this document is handled strictly in accordance with the CMO arrangements.

Your Secretary of State said that his minute summarised the conclusions he had reached in agreement with the Chief Secretary. The potential for local authorities to manipulate the Rate Support Grant (RSG) system if it was not quickly closed down were very great; City institutions were active in advising local authorities on possible manipulations, and the Exchequer was at risk to the tune of as much as £2 billion additional grant. Any hint that the Government was considering action to stall further manipulation could, within a matter of hours, lead to action by authorities running into hundreds of millions of pounds; tight security on the present discussions was therefore essential. Against that background he was persuaded that it was essential to make a statement as soon as possible, including an announcement of the amount of Exchequer grant to be made available in the 1989/90 RSG settlement. Action to close down the RSG system would require a short Money Bill next session, which would need to complete all its stages by the end of February 1989 so that local authorities were able to draw up their budgets and rates for 1989/90. He recognised that this would be unwelcome, given the pressure on the legislative programme, but such a Bill would be necessary in any event before the introduction of the Community Charge. An announcement on the lines he proposed would certainly be controversial, but your Secretary of State did not anticipate the row would be long lasting or damaging.

In discussion the following points were made:



- (i) it would be essential to check the legal position, in particular to ensure that the planned announcement would not run the risk of judicial review. The Attorney General, who had been sent the papers, should be asked to consider this aspect. The main potential sources of concern were the absence of prior consultation with local authorities, making the legislation retrospective to the date of the announcement and closing off the scope for local authorities to making supplementary claims for grant in respect of 1987-88 and 1988-89;
- (ii) consideration should be given to who would be the gainers and losers from the proposed change. A key point here was that, if action was not taken, the main gainers would be those authorities who had been most actively engaged in creative accounting devices. There was potential for some authorities to make massive gains in relation to past years. If no statement was made on the future of the RSG system by the time the capital control consultation document was issued, authorities would be given a clear incentive to embark on manipulation of the system;
- (iii) a possible drawback with the proposed approach was that, with a fixed grant in 1989/90, the disincentive to overspending would be removed and there would be no grant underclaim as in earlier years. On the other hand, in the absence of close-down, the incentive to authorities to engage in manipulation was in practice likely to lead to an even worse position and a grant overclaim. The only alternative approach would be a much tougher 1989/90 grant settlement, but this would then penalise all authorities for the creative accounting practices adopted by some of them. And it would be those authorities who had previously engaged in creative accounting who would be in the best position to deal with a general squeeze on grant;
- (iv) consideration might be given to earmarking a specified sum within the overall grant settlement as compensation to local authorities for the removal of their right to make supplementary claims for grant. One possibility would be to earmark £75 million for both last year and this year. This approach might help reduce the risk of judicial review. (You subsequently told me that your Secretary of State had now concluded that there would be legal and practical difficulties with this earmarking approach; and that he now felt it would be more appropriate to make a general statement in the settlement announcement indicating that it was more generous than would have been possible if the RSG system had not been closed down.)

- (v) the impact of the proposed change on the introduction of the Community Charge in 1990/91 should be considered. In general this factor favoured the proposed approach; without action to close down the RSG system authorities would have an incentive to run down their balances and set low rates in 1989/90, and then to introduce relatively high community charges in 1990/91;
- (vi) it was necessary to check whether the proposed legislation would indeed be a Money Bill. The key consideration was whether this was primarily a Bill involved with the Exchequer paying out grant, or whether it had a more general purpose relating to local authorities;
- (vii) the proposed Bill was most unwelcome in terms of the pressure on the legislative programme for 1989/90. Several other Bills required a "fast track" during the early part of the year. On the other hand, it was arguable that, if no early action was taken, subsequent action necessary to block off a wide range of loopholes exploited by local authorities would in the event lead to more Parliamentary time being taken up in 1989/90. One possibility which might be considered would be whether the proposed Money Bill could be handled in the Parliamentary overspill period although this too would have risks for the rest of the programme;
- (viii) the issues under consideration would need to be brought to E(LA). Your Secretary of State and the Chief Secretary should reach an agreed position on levels of grant and provision for 1989/90 before the E(LA) meeting. One point they would need to take into account was the percentage grant implied;
- (ix) the Secretary of State for Wales had put to the Chief Secretary a proposal that, in order to ensure that rate increases in Wales were not higher than in England, there would need to be additional Exchequer grant in Wales. It was agreed that, if the case for some adjustment in Wales was compelling, it would be appropriate to add a "gesture amount" to grant.

Summing up the discussion, the Prime Minister said that it was agreed that there was a strong case for taking the action proposed by your Secretary of State and the Chief Secretary and for an announcement to be made on 7 July. However, it was essential that, before a final decision was reached, the legal position and the threat of judicial review was thoroughly explored in consultation with the Attorney General; it was also necessary to check that the proposed legislation would be a Money Bill. The Lord President would give further consideration to the possibility of such a Bill being taken in the spillover period. The next step would be for the proposals to be put to E(LA) at a meeting on Wednesday evening. The Secretary of State for Energy would then make an

oral report to Cabinet on 7 July on the conclusions reached at E(LA).

I am sending copies of this letter to Alex Allan (Treasury), Alison Smith (Lord President's Office), Stephen Haddrill (Department of Energy), Jill Rutter (Chief Secretary's Office) and to Trevor Woolley and Richard Wilson (Cabinet Office).

*Yan,  
Paul*

PAUL GRAY

Roger Bright, Esq.,  
Department of the Environment.

passed on  
to PSI/CST

[CST was happy  
but she will  
take forward  
with Benny P]  
You said you  
would minute

m.



CONFIDENTIAL

redetermination that the additional £15 million should form no part of the base for the 1989-90 EL. The increase in the precept maximum had no effect on the EL, albeit on a technicality. A genuine cash freeze on 1988-89, therefore, would imply a 1989-90 EL of £910 million.

3. An EL next year as low as £190 million is impracticable. It would require savings compared to ILEA's 1988-89 budget of some £100 million, or almost 10 per cent - a larger year-on-year increase than has ever been achieved by any authority. The limit of practicable savings is probably nearer to the £85 million implicit in allowing one, but not both, of the additions to the 1988-89 EL to feed through into 1989-90 (ie an EL of £925 million). Savings of £85 million next year would be slightly less in absolute terms, although greater as a proportion of total spending, than the £90 million which Mr Baker believed would have been achievable this year.

4. We have considered carefully whether to recommend you to press for an EL of £925 million. We have reluctantly decided against it. Mr Potter's submission set out the unsatisfactory position on rate capping generally next year and the particular difficulties in relation to those single purpose authorities, including ILEA, previously subject to automatic limitation. To the extent that you were to press for a more stringent EL for ILEA, that would increase the chance of a legal challenge by ILEA, and of that challenge being successful, which might affect not just ILEA but the whole rate capping package. The additional saving in ILEA's spending next year which you might achieve is simply not worth the risk. This is especially so against the background of reduced concern about the level of inner London community charges in 1990-91. I understand that, for the same reasons, DOE officials are advising Mr Ridley also to accept Mr Baker's proposals.

*Stephen Kelly*

S KELLY

REVISED DRAFT LETTER FOR SECRETARY OF STATE FOR ENERGY

RATE LIMITATION: 1989-90

Nicholas Ridley has circulated proposals for rate capping certain general purposes local authorities in 1989-90. I have also seen the letters from Douglas Hurd, Kenneth Baker and Paul Channon setting out proposals for those single and joint purpose authorities for which they have responsibility. Given that both Douglas Hurd and Paul Channon do not believe it would be practical to limit any of their authorities, we face the prospect of applying rate limits only on seven general purpose authorities and ILEA in 1989-90.

It may be helpful if I set out my views at this stage. I do not wholly share Nicholas' view that his proposal to select only seven general purpose authorities for rate capping this year is a vindication of the rate capping system. I accept that there has been some progress in reducing underlying current expenditure in one or two authorities. Indeed nine of the ten authorities which were rate capped this year cannot be rate capped next year because they have reduced their reported total expenditure below the GRE + 12½% threshold. But that owes just as much to creative accounting used to drive a wedge between their reported

total expenditure and actual underlying current spending as to any genuine reduction in spending. In many of these authorities underlying expenditure remains unacceptably high.

Nonetheless I appreciate that the selection criterion to be applied to authorities previously rate limited in this year cannot safely be tightened further in the view of the legal advice given earlier. Nor can there can be any question of taking more vigorous action in the last year of the present scheme to change the basis of selection from the unsatisfactory concept of total expenditure in order to bring more authorities within the net. I am therefore reluctantly prepared to agree that only the seven general purpose authorities identified by Nicholas should be rate capped in 1989-90.

Our scope for selecting both passenger transport authorities (PTAs) and joint fire and civil defence authorities (FCDA's) also seems to be fettered by legal advice that we have been given. Because we have indicated that Expenditure Levels (ELs) for the present year for the PTAs represent a reasonable balance between the interests of the ratepayer and the transport user, I can well understand why lawyers advise that those same ELs cannot now be deemed excessive in the terms required under the 1984 Rates Act in order to justify



selection for rate-capping next year. This is to say the least unfortunate and I fear that one or two of these authorities may take the opportunity, while they have escaped from the net, to increase their spending and the precepts they make upon local ratepayers. But again I am reluctantly forced to accept that there is little we can do but accept that no joint police, FCDAs and PTAs can be rate capped next year.

I agree with Kenneth Baker that ILEA can and must be rate capped next year.

I am concerned, however, at how we present the overall picture which emerges of only seven general purpose authorities and only one other authority - ILEA - being subject to rate limitation next year. I accept that the Environment Secretary is not required under the terms of the Act to explain why an authority has not been selected. Yet I do not suppose it will take long for ILEA and perhaps one or two other authorities to question why PTAs and FDCAs whose expenditure exceeds the GRE + 12½% criterion proposed for selection this year have not in fact been selected. I think it is crucial that we present our defence in terms of the ELs for both the FDCAs and PTAs for this year as having been reasonable rather than excessive. What must not be done is to imply in any way that the failure

to select these authorities is some kind of reflection upon the accuracy of their GREs. That would be a particularly dangerous line to follow: it could prejudice our ability not only to rate cap ILEA but also some of the general purpose authorities. I suggest that DOE, DTp, Home Office, DES and Treasury officials should agree on how the rate limitation proposals should be presented.

As regards the level of ELs, I am content with Nicholas' proposal to set ELs for 1989-90 for the general purpose authorities as a cash freeze on their 1988-89 ELs; I believe that represents an acceptable balance between maintaining the downward pressure on these authorities' expenditure, while avoiding requiring excessive cuts in the level of services.

I am also prepared, albeit very reluctantly, to accept Kenneth's proposal for an EL for ILEA next year of £940 million. I should have preferred an EL at least £15 and ideally £30 million lower in order to reflect a genuine cash freeze on ILEA's 1989-90 EL. I can only agree to a figure as high as £940 million in the light of the wider considerations to which I have already referred. My agreement to such a high initial EL means that ILEA would need to present an overwhelming case before I could agree to redetermination at a still higher level. As Kenneth envisaged in his letter, we shall also need to look very carefully at the precept

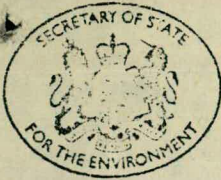
maximum in order to ensure that there is no scope for ILEA to boost its spending from other sources.

Finally I think there is an important wider lesson to be drawn from this year's experience. In 1989-90 we now face the prospect of capping only a very small number of authorities. Moreover all authorities will know that, because of the change in the capping arrangements from the present year arrangement which operates on the preceding year's budget to the new in-year control system, authorities can spend up in 1989-90 with no danger of being capped as a result. In the circumstances there is a danger of a surge in expenditure and we will therefore need to give careful consideration to our precise proposals for Community Charge capping. It will be important to retain the maximum flexibility to apply Community Charge capping on as wide a basis as seems desirable in the light of the budgets and Community Charge proposals produced by authorities in 1990.

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

CONFIDENTIAL

*pmf*



2 MARSHAM STREET  
LONDON SW1P 3EB  
01-212 3434

My ref:

Your ref:

The Rt Hon Cecil Parkinson MP  
Secretary of State  
Department of Energy  
Thames House South  
Millbank  
LONDON  
SW1P 4QJ

CHIEF SECRETARY	
REC	5 JUL 1988
<i>Mr Potter,</i>	
<i>Cx Sir Middleton</i>	
<i>Mr Dawson, Mr Phillips, Mr Edwards</i>	
<i>Mr Tombull, Mr Jellgelt, Miss Noble,</i>	
<i>Mr Wood, Mrs Case, Mr Call.</i>	

July 1988

*Dear Cecil*

RATE AND PRECEPT LIMITATION 1989/90

Since colleagues and I last corresponded about next year's rate capping round, the meeting of E(LA), when we were planning to discuss our proposals for capping, has been cancelled. In these circumstances I suggest we might seek to agree our various proposals by correspondence, and hence I am now writing to seek your agreement to my proposals for general purpose authorities, and to let you know my views on colleagues' proposals for their joint authorities.

My own proposals were set out in my Memorandum (E(LA)(88)3) of 17 June. I believe the selection criteria I am proposing are the tightest we could adopt without an unacceptable risk of legal challenge, and my proposals for Expenditure Levels (ELs) will continue to maintain pressure on the overspenders. I recognise that some colleagues might be concerned about the effects of these ELs on some of the authorities I propose to cap, but I believe the proper time to have regard to these specific concerns is at the redetermination stage when we can take a hard look at any representations authorities may wish to make about their individual circumstances. I should therefore be grateful for your agreement to proceed on the basis of these proposals.

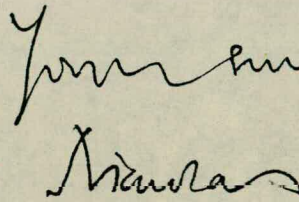
I have considered carefully colleagues' proposals for ILEA, the Passenger Transport Authorities, and the joint Police and joint Fire and Civil Defence Authorities. Given the legal advice they have received, I am content with Douglas Hurd's and Paul Channon's proposals not to select any of their joint authorities. As I said in my letter of 21 June to Kenneth Baker, it is important that ILEA is securely capped and that further significant reductions are achieved in their spending. On the other hand it is also important that we do not constrain ILEA so tightly that the smooth reorganisation of education in inner London is put in jeopardy. I am therefore content with Kenneth's proposal to select ILEA and to set an EL of £940m.



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In my earlier correspondence with colleagues, I also mentioned the importance of presenting our various decisions on capping in such a way as to avoid any inconsistencies which could be exploited in a legal challenge. I should be grateful if our officials could keep in touch about how we present our various decisions both at the time when we announce them and subsequently through the capping round.

I am copying this letter to the other members of E(LA), to the Attorney-General, and to Sir Robin Butler.

A handwritten signature in dark ink, appearing to read 'Nicholas Ridley', written in a cursive style.

NICHOLAS RIDLEY

CONFIDENTIAL

CHIEF SECRETARY

FROM: B H POTTER

Date: 5 July 1988

cc: PS/Chancellor  
Sir Peter Middleton  
Mr Anson  
Mr Edwards  
Mr Fellgett

## RSG SETTLEMENT: PRESENTATION OF DOE STATEMENT

At the meeting with the Environment Secretary last Thursday 30 June, it was agreed that the quantum of grant for 1989/90 in England would be £13,575 million. That is recorded in the minutes of the meeting.

2. You will recall, however, that, first in the context of how much grant should be made available and later in the context of presentation, there was debate about whether Mr Ridley should describe some element of this total grant as grant repayment for 1987-88 and 1988-89. This repayment would reflect the normal tendency for outturn expenditure to be lower than budgetted expenditure (on which grant is paid), and for a grant repayment to LAs in respect of this to be paid out via a Supplementary Report in a later year.

3. At the meeting you accepted that Mr Ridley should have discretion on the question of presentation. We have now heard that Mr Ridley intends to present the £13,575 million for AEG as all for 1989-90. This has the advantage from DOE's point of view of keeping up the grant percentage. But I fear it has a major risk for us - that, having not given anything for earlier years, Mr Ridley will come under strong pressure to do so. Past experience suggests that once the pressure becomes strong, Mr Ridley will then seek additional grant above the £13,575 million.

4. I do not think we should underestimate the likelihood or strength of such pressure: it is the main feature of a fixed grant settlement which is open to criticism. In effect we are rewarding the imprudent and punishing good financial management.

5. But having agreed discretion for Mr Ridley on presentation, you cannot now withdraw it. Nonetheless, on balance, we recommend that you should write to Mr Ridley putting forward your own thoughts on the presentation. The line would be that, having given it further consideration you see two advantages in making it clear there is an allowance within the total for grant repayments for earlier years. (Ideally this would be an explicit sum, but at the least an acknowledgement of the basis of the grant (ie that it includes such an allowance) should be made.)

(i) The grant repayment for earlier years would clearly not be for this year and therefore not intended to support expenditure in 1989-90. Indeed some part of <sup>the payments</sup> them would not normally have been received till 1990. Therefore Mr Ridley could indicate that he hoped such repayments of grant would be added to balances and be available to keep down the Community Charge in 1990-91.

(ii) Without this attribution of an amount for grant repayment for earlier years, very strong pressures will build up to make even more grant available next year in recognition of prudent management for preceding years. That would be politically awkward. But having firmly if reluctantly agreed the total quantum of grant at £13,575m for 1989-90, there can be no question of adding to that - whatever the pressure.

6. If you agree, I attach a draft letter for you to send to the Environment Secretary.

Barry H. Potter

BARRY H POTTER

**DRAFT LETTER TO ENVIRONMENT SECRETARY**

**RSG PRESENTATION**

We agreed last week that the total quantum of AEG in England for 1989-90 should be £13,575 million and that you would decide how the grant settlement might best be presented. I have also been giving further consideration to presentation and, in particular, how we can most satisfactorily defend the agreement we have reached.

I see considerable advantage in describing some element within that total as being grant repayment for the earlier years 1987-88 and 1988-89, to reflect the likelihood that outturn expenditure will be lower than budgets. One option would be to identify an explicit sum - say £75m pa - within the total, as you suggested. But at the very least, we should acknowledge from the outset that there is an implicit allowance for such grant repayments within the announced total.

This form of presentation would allow us to identify part of the grant for 1989-90, as intended not to support expenditure next year, but rather as an amount which ought to be added to balances and therefore be available to keep down Community Charges in 1990-91. Moreover I am concerned, that without some explicit



acknowledgement that prudent budgetting this year and last year is being rewarded in our grant proposals, we will come under very strong pressure to make even more grant available. I must reiterate that my reluctant agreement to a quantum of £13,575 million for 1989-90 was on the basis that it would be the total cash amount for next year; there can be no question of any extra grant payments over and above that amount.

I am copying this letter to the Prime Minister, the Secretary of State for Energy and Sir Robin Butler.

CONFIDENTIAL

FROM: BARRY H POTTER

DATE: 5 July 1988

CHIEF SECRETARY

cc PS/Chancellor  
Sir P Middleton  
Mr Anson  
Mr Edwards  
Miss Peirson  
Mr Fellgett

## RSG SETTLEMENT: WALES

Mr Fellgett and I discussed the RSG settlement for Wales with Welsh Office today. At official level we reached - with considerable difficulty - a provisional understanding which we agreed to put to our respective Ministers. The proposal is for a fixed grant settlement for 1989-90 of £1316 million; that is equivalent to the same percentage increase in AEG for 1988-89 as in England, plus a further £5 million to reflect "special circumstances in Wales".

2. The Welsh Secretary wrote to you on 1 July accepting the principle of a fixed grant settlement but arguing that special circumstances in Wales - specifically the low rateable base - required extra grant in order to be consistent with broadly comparable rate increases in 1989-90 to those projected for England, for broadly comparable levels of spending. I understand that Mr Walker's letter was discussed at the Prime Minister's meeting on Monday and that the inclination was not to give much if any recognition in higher grant for these special circumstances.

3. In the morning session, Welsh Office argued for grant of £1342 million for 1989-90. On the basis of an increase in spending of 7½% above local authorities' budgets for 1988-89, this amount of grant would be sufficient to keep rate increases in Wales broadly in line with those for the non rate-capped authorities in England. (No Welsh authorities are rate-capped.) However we argued that the Welsh figures took no account of likely use of special funds and made no allowance for buoyancy in their

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rate basis. Once those adjustments were made, a rather lower quantum of grant would be consistent with rate increases broadly in line with those projected for the non rate-capped authorities in England.

4. We suggested a figure of £1311 million for AEG in Wales. This was on the basis of the same percentage (4.6%) uplift in 1988-89 AEG for Wales as in England. We had to acknowledge that this would not be enough to suggest rate increases in Wales would be in line with those forecast for England. But we did not accept such an objective for Wales: rate bills are very much lower in Wales than they are in England at present. Moreover rate increases were not the only criterion to be considered: in particular the danger of encouraging a surge in expenditure if too much grant were provided, carried greater weight in the view of Treasury officials.

5. I understand that Welsh Office officials somehow contacted Mr Walker after the morning session, despite the fact that he is in Russia. He agreed that they should settle at £1325-£1330 million. After further discussions in the afternoon, and consistent with the negotiating brief you gave us yesterday, I suggested that a further £5 million might be available in recognition of the low rateable value base in Wales (on the understanding that this was a proposal subject to your approval). I did however venture to indicate that refusal to settle at £1316 million overnight would be likely to make us revert to £1311 million; and that Welsh Office Ministers would then have to take their case before E(LA) tomorrow and very likely to full Cabinet on Thursday. Welsh Office officials then reluctantly agreed to recommend a settlement of £1316 million to their Ministers this evening.

**Conclusion**

6. I recommend that you accept a fixed grant settlement of £1316 million for 1989-90 in Wales. Even at this level, unless Welsh Office officials assume a heavy drawdown of special funds - and Welsh Office budgets for this year show no drawdown

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of special funds - they will find it difficult to present such a settlement as allowing rate increases in Wales for 1989-90 to move broadly in line with those projected in England. There is no real danger that such a settlement can be presented as being much more generous than in England. It is certainly a little higher in terms of the overall percentage increase in AEG but the Welsh will for example face extra costs in preparing for the Community Charge, eg bilingualism and a much higher proportion of Community Charge rebates. Nor do I think that such a settlement would create any damaging precedent for the negotiations with Scotland still to come.

7. Welsh Office officials are to brief Mr Wyn Roberts tomorrow: I understand he is attending the E(LA) discussion and is unfamiliar with the subject. If you wish to go for a tougher deal than £1316 million, it would be desirable to arrange a meeting some time tomorrow with Mr Roberts. Alternatively if you are content I suggest your Private Office might telephone Mr Roberts' Office tomorrow.

8. Subject to your view, we will need to consider early tomorrow how the Welsh settlement is best handled in E(LA). Depending upon your decision we will also provide briefing during the course of tomorrow on the Welsh settlement.

*Barry H. Potter*

**BARRY H POTTER**

Separate note submitted  
on Welsh settlement. Briefing  
on Wales will be provided  
tomorrow. BHP 5/7

FROM: R FELLGETT  
DATE: 5 JULY 1988

1. MR POTTER
2. CHIEF SECRETARY

cc

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

[Alex - not shown to Ch...  
can do what you show during  
day...]  
1989-90 RSG SETTLEMENT

This submission provides briefing for the meeting of E(LA) at 6.00pm tomorrow (6 July), which will need to settle all necessary outstanding issues ahead of the announcement of the RSG Settlements for England and Wales and closedown in both countries.

2. On closedown, you will wish to support the proposition in Mr Ridley's paper that the present RSG systems should closedown forthwith in both countries. The arguments are all in the paper at appendix A to Mr Ridley's paper, and are unlikely to be rehearsed much. Colleagues seem unlikely to object to this proposal.

3. You will, however, wish to insist (and have recorded in the minutes as necessary) that agreement to closedown is on the understanding that:-

- Wales should closedown with England to avoid invidious comparisons between similar counties each side of the border in countries with similar grant systems;
- DOE provide satisfactory assurances that the legislation will be watertight, and safe from judicial review substantially undermining its policy purpose, as the Prime Minister earlier requested;

- it is absolutely clear that the necessary, and admittedly controversial, Bill will be taken through the Commons without any financial concessions.

4. Colleagues are unlikely to complain about the level of Aggregate Exchequer Grant that you have agreed with Mr Ridley should be paid in 1989-90. They may feel bounced, but they will have no overriding reason to object on service grounds and cannot reasonably complain about projected rates rises of 5% on average, less than in 1988-89. If necessary, you can explain that:

- you have very reluctantly moved from your earlier position of an increase of £520 million to an increase of £600 million, and agreed to forego a potential underclaim estimated by DOE at £350 million in recognition of the fact that some repayment of underclaim would normally be expected for each of the three years 1987-88, 1988-89 and 1989-90; and to avoid specious grant payments generated by creative accounting;

- the grant actually to be paid in 1989-90 is therefore around £1.1 billion more than in 1988-89, a substantial increase of around 8% which will even on DOE's projections produce modest rate rises of just 5% (compared to average rate rises of over 7 percent in 1988-89).

5. You will wish to insist (and have minuted) that this is your last word on grant, and that it takes full account of the repayments that might otherwise be made in respect of earlier years.

6. E(LA) should agree without difficulty that the capital consultation paper should issue, also on 7 July.

7. Mr Ridley is now simply proposing that there should be an unallocated margin, without seeking agreement to its size. You can accept this, but refuse to settle on any figure for the size of margin. You can agree in principle with Mr Ridley's argument

that a margin is needed to signal that the aggregate of GRE (the Government's view of what local authorities need to spend) is not as great as its view of what they are likely to spend (ie broadly provision). The size of margin and hence the aggregate level of GRE within the agreed level of provision will then be decided later; at that point, higher GRE (which service colleagues will favour strongly) might usefully be traded-off against other objectives.

8. The proposals on rate capping should also be agreed without dissent.

9. The major debate is therefore likely to be on expenditure provision. Your intention is to argue for something less than Option 2, perhaps Option 3, with the aim of allowing Mr Parkinson to sum up in favour of Option 2, which is Mr Ridley's position. A note of the main points to make is attached.

10. Service colleagues are, however, likely to argue strongly for provision higher than option 2. Although it is 8% more than provision in 1988-89, public comparisons will inevitably be made with local authorities own budgets and option 2 therefore treated as broadly a real terms freeze (plus community charge costs). An increase in police expenditure of perhaps 10% is unavoidable (8% for pay and 2% for manpower increases already agreed), as may be a teachers pay settlement of at least 5% and probably volume growth in personal social services of at least 1% to allow for the aging population and post Cleveland efforts. Together, these three areas amount to almost half of local authority spending. Within option 2 provision, the remaining areas will therefore face an increase of only 2%, or a real terms cut of 2%. Service colleagues are likely to be aware of this very broad arithmetic, and to be accordingly firm in their arguments for something over Option 2 provision.

11. Indeed, we need to be cautious about settling provision so low that a subsequent decision, say on the teachers pay settlement, could only be handled by increasing the total of

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provision. That would be liable to reopen the grant total as well. There would therefore be something to be said from your viewpoint also for compromising between options 2 and 1, but that has to be set against the wider Survey considerations.

12. Finally, you asked how Option 2 provision had changed from £29.1 billion to £29 billion. I gather that £50 million of the reduction reflects a lower budget return by Camden to DOE, and £40 million is a result of correcting a misunderstanding between DOE and Home Office officials about the interpretation of police expenditure figures in a number of authorities budget returns. The remaining £10 million is the net result of a number of minor adjustments, mainly to take into account later information.

*Robin Fellgett*

R FELLGETT



**Arguments for provision below option 2**

(Option 2 is £29 billion; up 8% compared to provision in 1988-89; up 4% plus £110 million Community Charge costs compared to local authorities own 1988-89 budgets; a claim of £1.2 billion on the Reserve).

1. Cannot provide as much as £1.2 billion from Reserve (of £7 billion). Would compromise the rest of the Survey, where colleagues have put in very substantial bids for their central government programmes.

2. Must not increase provision by 8% compared to provision we agreed for 1988-89. That would be twice the rate of inflation. Utterly the wrong signal to give to local authorities, and might be seen in financial markets and elsewhere as the government losing its grip.

3. The level of provision (and implied claim on the Reserve) matters crucially in the presentation of the RSG Settlement now. By the Autumn, when colleagues will need to defend the service allocation to their programmes, we will (if colleagues agree) have announced a new planning total which will no longer include local authority expenditure.

4. [For use if Mr Ridley mentions this argument - DOE are being reticent about it, and points about the distribution of grant are primarily for the Environment Secretary]..Believe that the 'resource equalisation system' in the present RSG system means that, at a fixed level of grant, higher provision actually diverts grant away from high resource south eastern areas towards low rateable value authorities in the north and west.

**Defensive**

5. Service provision needs to be fully realistic and take account of individual bids for extra policemen, teachers pay etc etc.

- We have always defended service provision a little less than local authorities might in the event spend and this will be easier than ever once the new planning total is announced;
- Will discuss individual service bids later, and take full account of expenditure increases to which the government is committed in deciding on the service allocation of overall provision in the Autumn.

Need to push up provision to enable GRE's to be pushed up also:

- Aggregate of GRE's an issue to be settled in deciding on the size of unallocated margin that would be right with any agreed level of provision. Note that Environment Secretary's earlier proposal already involves 8% increase in aggregate level of GRE.

Government committed to higher LA spending (appendix D to Mr Ridley's paper):

- Note that £800 m commitment mentioned at last E(LA) now costed as £690 m; can be accumulated within provision options; just two and a half percent out of 7% increase in provision under Option 3 or 8% increase in provision under Option 2.



OK ✓

Ch

I gather CST feels he should tell the Leagues this evening that the GDP deflator for 1989-90 is being upped to  $4\frac{1}{2}\%$ , and more to a <sup>correspondingly</sup> revised option 2 for provision (ie  $4\frac{1}{2}\%$  up on 1988-89 budget). He feels that if he doesn't, they will feel v aggrieved on Monday, and this ~~might~~ might cause them to raise difficulties at the public expenditure cabinet.

If you are content with this, CST sees no need to come over for a word. OK?

over

[I think this is probably right. So long as we are not tied to the grant percentage, higher provision does not automatically mean more grant. Potentially difficulties are (a) presentation of even higher increase (b) still lower grant percentage leading to pressure for more grant and (c) ~~provision~~ cannot adjust reserves by less than £ 1/2 bn so extra provision may raise planning totals (though won't necessarily). But real problems over settling RSE on Wednesday on one  $\rightarrow$  DP assumption & then upping it the following Monday. Only real alternative would be to go back to 4% of AA

assumption for RES, with consequent diffs in October

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- 1. MR EDWARDS *ADCE*
- 2. CHIEF SECRETARY

FROM: R FELLGETT *RF*

Date: 6 July 1988

cc: PS/Chancellor *←*  
 Sir Peter Middleton  
 Mr Anson  
 Mr Potter  
 Mr Turnbull

*Ch*  
*Word with CST*  
*this afternoon?*  
*yes*  
*AA*

1989-90 RSG SETTLEMENT

Further to my submission of last night, we understand that following the Chancellor's meeting yesterday, departments are due to be told on Monday, in advance of the 14th July Cabinet, that the GDP deflator for 1989-90 is to be raised from 4% to 4.5%. You will wish to consider whether, for the same reasons, you ought to mention this change at some suitable point in the E(LA) meeting. *this evening* The problem is, clearly, that if you do not do so, there will be accusations of bad faith from colleagues next week, and it may be difficult to agree forms of words for the RSG statements tomorrow. If you do decide to mention the change, Mr Edwards would be grateful for authority to brief a senior official in both DOE and Cabinet Office in advance of E(LA) this evening.

2. In our view, the early change in the deflator reinforces the arguments in paragraph 11 of my submission for accepting a compromise/<sup>on expenditure provision</sup> higher than option 2, perhaps between options 1 and 2. The danger is that the Government would ultimately be unable to sustain provision which implied real-terms cuts for many local authority services and would have to increase it. There are particular dangers that we would come under pressure to increase provision when substantial policy issues are settled with local authority expenditure implications - perhaps most

significantly, when Ministers decide in the autumn on the remit to the Interim Advisory Committee on teachers pay for 1989-90. If provision has to be raised, we will face intense pressure to raise grant (which is set in law, and defended publicly as a matter of practical politics, in the light of provision).

3. The broad arithmetic is as follows. A 10% increase in police pay expenditure seems unavoidable (8% for pay rises and about 2% for manpower increases already agreed). It will be difficult to settle on a teachers' pay increase below 5%, and there will be pressures to concede some real terms increase in Personal Social Services provision in view of demographic pressures and the attention focused on this area by Cleveland and similar cases. As the table below shows, provision option 2 would leave at best only about a 2.4% increase in cash terms (ie a 2% reduction in real terms), compared to local authority budgets for 1988-89, for all other local authority services on average. Some may have to get substantially less.

	1988-89 budgets	1989-90 provision option 2	£m
Police	2,700	2,970	10%
Teachers	7,000	7,350	5%
PSS	3,000	3,150	5%
Rest	15,170	15,530	2.4%
	<hr/> 27,870	<hr/> 29,000	

4. We therefore conclude that there is a real risk of provision and AEG being re-opened later in the year if we do not now agree a figure higher than option 2 and perhaps somewhere between options 1 and 2 in Mr Ridley's paper. You will wish to bear this in mind. I understand from Mr Turnbull that the consequent claim on the Reserve of between £1.2 billion and £1.5 billion in 1989-90 would be awkward for the Survey arithmetic, but could be accommodated.

*Robert Fellgett*

R FELLGETT

Alex: I have spoken to  
AG office about classification  
of document. They have  
decided it should be  
CMO until further notice.

With the Compliments of I have informed  
the Attorney-General CST's office  
who usually Action  
these PPS out.

Attorney General's Chambers,  
Law Officers' Department,  
Royal Courts of Justice,  
Strand, W.C.2A 2LL

01-936 6201

*With the Compliments of  
the Attorney-General*

*Attorney General's Chambers,  
Law Officers' Department,  
Royal Courts of Justice,  
Strand, W.C.2A 2LL*

01-936 6201





01-936 6201

ROYAL COURTS OF JUSTICE  
LONDON, WC2A 2LL

*Handwritten initials*

CONFIDENTIAL : CMO

The Rt. Hon. Nicholas Ridley, AMICE, MP  
Secretary of State for the Environment  
2 Marsham Street  
LONDON SW1P 3EB

*Good*

6 July 1988

CH/EXCHEQUER	
REC.	-6 JUL 1988
ACTION	
COPIES TO	

*Nicholas*  
1989/90 RSG SETTLEMENT

You copied to me your minute of 1 July to the Prime Minister in connection with the risk that local authorities will seek, by various dubious accounting practices, to maximise their rate support grant entitlement in the final year of the present RSG system.

I have considered carefully the details of your preferred option for closing down the present system. Your basic objective is to secure that the spending assumptions which form the basis for the imminent RSG Report for 1989/90 should also form the basis for any Supplementary Report or calculation of RSG for 1989/90, without the need to update those assumptions by reference to information which subsequently becomes available. Moreover, in the calculation for any earlier year for which there had been no final determination of RSG you would wish to take account of information available to you on or before a chosen cut off date in July 1988. These proposals are to be carried into effect by an early announcement in Parliament of what is proposed, followed by a short Bill which will, in effect, relieve you of any obligation to take account of information which comes to light after the cut-off date.

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Your proposed announcement to Parliament will of course be no more than a statement of intention to change the law, and no such change will be effected until the Bill you propose has received the Royal Assent. It is obviously essential that, during the period between the date of your announcement and the granting of Royal Assent, you and your officials act in accordance with the statutory provisions for the time being in force, albeit that you know that the position will change after Royal Assent. Those local authorities which are hostile to your policy will not be slow to challenge in the Courts any failure to comply with the present law for so long as it remains in force. However, while you are obliged to comply with your existing statutory duties and powers, and may not (for example) select an option which it would not otherwise be appropriate for you to adopt within that framework, you may relevantly take into account the prospect of the enactment of the proposed Bill when you make decisions or exercise discretions in the context of the present RSG system. I understand that your officials have had the advice of Counsel on this point.

Although there will be no question of your making any Supplementary Report or calculation by reference to the proposed cut off date until after the Bill receives Royal Assent, the Bill is retrospective to the limited extent that you will be enabled to leave out of account information arising prior to Royal Assent which you would otherwise have been obliged to take into account. The Law Officers advised in February on an earlier proposal by your Department (in relation to loopholes in the capital control system) to announce new policy and to give the legislation retrospective effect to the date of the announcement. On that occasion we observed that it was constitutionally undesirable to employ this device in circumstances where a long interval was expected to elapse between the announcement and the enactment of the relevant legislation. By way of guidance we suggested that the device should be used only where the policy was to be implemented by a provision in a Bill currently before Parliament at the time of the announcement or which is to be introduced in the same Session. That guidance was not, however, intended as an inflexible rule. It is clear that by

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mid-July in any year there is no realistic possibility of getting a controversial Bill, however short, through all its stages by the end of the current Session. In the present case, despite the fact that the anticipated period of 9 months between the dates of your announcement and of Royal Assent to the proposed Bill is a significant one, I am satisfied that your need to act quickly to pre-empt abuse of the RSG system does justify the modest degree of retrospection that the Bill will involve, particularly as it is your intention to introduce it as early as is practicable in the new Session. I would not therefore wish to raise any objection to it on constitutional grounds.

Following your announcement, there will be complaints from local authorities that there has been no consultation about the changes you have proposed. This is inevitable, because any period of consultation would have afforded to local authorities the opportunity to exploit the very abuses of the system that you are seeking to eliminate. I am satisfied that the absence of consultation can in these circumstances give rise to no significant risk of successful legal challenge, because your announcement will in effect be no more than a statement of your intention to promote primary legislation. It is nevertheless important that local authorities be given early notice of the terms of your announcement, which should, of course, accord exactly with the terms of the instructions to the draftsman of the proposed Bill.

I am sending a copy of this letter to the Prime Minister, and the other recipients of your minute.

*Lawson,*  
*ALW*

---

CONFIDENTIAL

# dti

the department for Enterprise

BF 1517

18/7 2017

The Rt. Hon. Lord Young of Graffham  
Secretary of State for Trade and Industry

The Rt Hon John Major MP  
Chief Secretary to the Treasury  
Treasury Chambers  
Parliament Street  
LONDON  
SW1P 3AG

Department of  
Trade and Industry

1-19 Victoria Street  
London SW1H 0ET

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Direct line 215 5422  
Our ref PS7AJT  
Your ref  
Date 11 July 1988

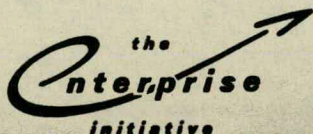
CHIEF SECRETARY	
REC.	11 JUL 1988
ACTION	Mr Walker
COPIES TO	C. Sir P Middleton
	Mr Anson, Mr Mack
	Mr Burgess, Mr Turnbull
	W. Call

*John*

### ENGLISH ESTATES' FUTURE STRATEGY

Kenneth Clarke and I have been considering with the Board of English Estates how they should modify their approach to the development programme in the Assisted Areas. We have been doing so against the background of an improvement in market conditions which holds out the prospect of renewed private sector activity in a number of areas which have hitherto relied exclusively on public sector provision. Your officials have already seen a copy of an initial strategy document prepared by the Board which has helped us to reach our general conclusions.

... Those conclusions are set out in the attached draft statement which we propose, with your agreement, to make before the Parliamentary Recess. Our broad objective is to get English Estates to distinguish clearly between those parts of the Assisted Areas and those products where renewed activity by the private sector is likely (the implication being that English Estates should withdraw) and those where public sector intervention either directly or with some form of risk sharing arrangement continues to be necessary to support the provision of industrial and commercial accommodation.







the department for Enterprise

**DRAFT PARLIAMENTARY STATEMENT: EIEC**

As the White Paper, 'DTI - the department for Enterprise', Cm 278 made clear, the activities of English Estates are an important instrument of our policies which seek to support economic development and encourage enterprise in the regions and inner cities. The recently launched programme aimed at increasing the supply of managed workspace in the inner cities has added an new dimension to their role which is likely to have steadily increasing importance in future.

In the Assisted Areas the essential role of English Estates is to seek to ensure that suitable premises and sites are available to meet the needs of new and growing businesses which would not otherwise be met. It does this in a variety of ways including the development of factories, workshops and offices either in advance of demand or to meet the needs of specific customers. It also actively facilitates provision by private sector developers, investors and owner occupiers.

Improving economic conditions have enabled English Estates in recent years to achieve successive annual improvements in the amount of floorspace let and

sold. There is, nevertheless, an unsatisfied demand for premises which, combined with rising rental levels and the prospect of continuing economic growth, is leading to renewed interest by the private sector in providing industrial and commercial floorspace in some parts of the Assisted Areas. If the property needs of industry and commerce are to be met, it is essential that this interest should be further encouraged. This requires a suitable response on the part of English Estates. We have, therefore, been considering with the Board of the Corporation how the planning and execution of its Assisted Areas programme should be developed.

On the basis of advice from the Board we have concluded that in order to reinforce existing market trends English Estates should adopt fresh approaches designed to secure increased private sector activity wherever possible.

This will affect English Estates' policies towards rental levels and sale prices. Hitherto, the general requirement has been that these should be set at the maximum level the market would bear. For the future English Estates will have the more specific objective of endeavouring to increase rents and sale prices to

levels which will make equivalent developments attractive to the private sector.

The emphasis of English Estates' development strategy will also change substantially with the aim of securing increased private sector activity. Thus English Estates role as a facilitator will assume much greater significance through the marketing of development opportunities, the preparation and disposal of serviced sites, joint ventures and the sale of completed schemes to investors. English Estates will only use its own development funding in the areas and for the products where private sector provision remains inadequate.

Thus in considering the shape of its future programme in the Assisted Areas English Estates will have regard to three categories of area and types of property. In the first, the presumption will be that the private sector will be meeting demand without the involvement of English Estates. In the second, it is likely that English Estates will need to participate in some form of joint venture in some types of development if private sector involvement is to be triggered. We shall consider with English Estates the cost-effectiveness of particular arrangements which may be necessary to encourage appropriate private sector





the department for Enterprise

provision. In the third, where there is no immediate prospect of private sector provision, English Estates will continue to act as a funder and developer, but on the basis of the rentals and sales policy outlined above.

In future I shall be determining the size of English Estates' annual development programme on the basis of advice from the Board about market demand, the likely level of private sector provision and the availability of public sector resources. I shall also take into account the need to balance the demand for resources between the Assisted Areas programme and the new inner city managed workspace programme as the latter develops. Decisions about which developments are to be undertaken will remain the responsibility of the Board acting within the framework I have just described. I have asked the Board to take steps to publish regularly a programme describing the projects planned to be pursued in each region in particular financial years. I shall expect the geographical boundaries of that programme to take full account of changing rental levels and development costs.

1. Alex  
2. Julie (PI folder)

FROM: R FELLGETT  
DATE: 13 July 1988

- 1. MR POTTER
- 2. CHIEF SECRETARY

1. Alex [I'm not  
minuting out]  
2. pwp.

*Good. I trust  
DOE will be all  
to get the Bill  
right in time.*

- cc PS/Chancellor
- PS/Financial Secretary
- PS/Paymaster General
- Sir P Middleton
- Mr Anson
- Mr Phillips
- Mr Edwards
- Mr Turnbull
- Miss C Evans
- Mr Tyrie
- Mr Call

**RATE SUPPORT GRANT BILL**

At E(LA) on 6 July and at Cabinet next day, you secured agreement that the Bill to close down the RSG system might be taken in the overspill at the end of the present Session, or at least that this option has to be kept open. I accompanied Mr Potter to a Cabinet Office meeting this morning, at which it was agreed that the Bill would indeed be taken in the overspill, so that the RSG settlement for England and Wales would be laid before Parliament subsequently in the new Session under the new legislation.

2. The intention is to introduce the Bill on 19 October when Parliament returns. All stages would then be taken on the floor of the House. (The Bill will indeed be a Money Bill, so Lords stages can also be dealt with promptly).

3. All parties at the meeting agreed that this was the right approach. DOE now recognise that it would be simpler than their previous aim of taking the RSG settlement before the legislation. It is also convenient for the business managers: they would prefer to take Commons business in the overspill, rather than losing 4 days from the new Session.

4. DOE were put under clear notice that this Bill had to be correct when it was introduced, and there could be no question of redrafting it by Government amendment in Committee. They accepted the point.

5. I understand that Mr Ridley will be writing shortly to propose this course of action.

*Rf* *Jones*  
R FELLGETT

1. Mr Neil Williams (IAE2) *24/7*
2. Mr Waller *More drafting change*
3. Chief Secretary *15/7*

From: Michael Romberg

14 July 1988

File IRARD J/11

cc Sir Peter Middleton  
Mr Anson  
Mr Monck (Industry)  
Mr Burgner (IAE)  
Mr Stevens (IAE2)  
Mr Turnbull (GEP)  
Mr MacAuslan (GEP1)  
Mr Richardson (GEP2)  
Mr Meyrick (EI)  
Ms Osmond (CA)  
Mr Ellis (P2)  
Mr Call

## ENGLISH ESTATES: FUTURE STRATEGY

### Summary

1. English Estates build factories in the assisted areas. In parts of the assisted areas, this function could be left to the private sector. Lord Young's letter of 11 July 1988 shows that he is planning a withdrawal strategy. This is encouraging. The details have yet to be worked out. But Lord Young would like to make a statement now. To avoid prejudicing Survey discussions and consideration of English Estates' forthcoming corporate plan, the statement would have to be non-committal, and there seems little real advantage in making it. But, so long as it is sufficiently non-committal, there would be little harm. Therefore, subject to minor points on drafting, I recommend that you do not object to the statement. A draft reply is attached.

## Background

2. English Estates build factories in the assisted areas. An initial look by English Estates at yields on their factories suggested that the assisted areas could be divided into three categories:

(i) in some parts, yields should be high enough to let the private sector operate freely; here, English Estates should cease to act as a developer;

(ii) in some parts where such attractive yields were in prospect, rents should be raised and joint ventures with the private sector should be pursued, perhaps involving rental guarantees.

(iii) in other areas the return of the private sector was still a long way off, and English Estates should continue to act as a developer as at present, although it should seek actively to raise rental levels.

3. We do not know the balance of size of these three sectors. English Estates' initial look was not detailed enough to let decisions be made. A number of ways of encouraging private sector provision have been canvassed, including long rental guarantees, but we have not yet had detailed proposals.

4. Lord Young's letter of 11 July 1988 wishes to make a statement now by way of an arranged written answer in order to :

(i) ease problems of staff morale; and

(ii) counter criticisms of inadequate factory provision in the North East.

5. You will need to ensure that nothing is said publicly which would prejudice discussion of resources in the Survey, for example by promising higher activity in those areas where English Estates would continue to operate. Provision for English Estates is £19m a year. The initial advice to you on the Survey suggests that you should seek a modest reduction in baseline of £2m because of: the withdrawal strategy; and the difficulties in finding private sector firms interested in participating in English Estates' inner cities managed workspace programme.

6. Since the statement could not contain details, it is difficult to believe that it would be effective in meeting either objective. But provided that the statement was sufficiently non-committal, you need not object to Lord Young making it. With a few minor drafting points, Lord Young's draft is acceptable.

7. A draft letter is attached.

MR

Michael Romberg

IAE2; 270 4662; Rm 114/G

DRAFT OF 14 JULY 1988

The Right Honourable  
The Lord Young of Graffham  
Secretary of State for Trade and Industry  
1 - 19 Victoria Street  
London  
SW1

**ENGLISH ESTATES: FUTURE STRATEGY**

1. Thank you for your letter of 11 July 1988.
2. The role of English Estates is to provide factory premises only where there is clear evidence of market failure, and where State provision does not run the risk of perpetuating that market failure. I therefore welcome your decision to take steps to ensure that English Estates operate within that framework by pursuing a withdrawal strategy. It is sensible to ensure that English Estates withdraw from areas where the market could provide premises, or where English Estates' continuing intervention is likely to delay further the return of market operators.
3. However, it is too early to take decisions on the withdrawal strategy without looking in detail at the arrangements for ensuring its success in the context of English Estates' corporate plan. Consequently, any public statement that was made at this stage would have to be consistent with a wide range of possible outcomes for decisions on the details of the withdrawal strategy. In particular, future levels of resources for English Estates are a matter for the Survey.
4. Given that inevitable constraint, I am not convinced that a statement would help you to deal with the two areas of concern that you face: staff morale; and pressures on premises in the North East. If you are nonetheless particularly keen to make one, I would not wish to stand in your way. Subject to a few drafting changes annexed to this letter, I can agree to the draft written answer which you have proposed.
5. My agreement to this statement is on the understanding that nothing which is said subsequently in elucidation of the statement goes beyond the terms agreed, before I have had the chance to consider your detailed proposals on the implementation of the withdrawal strategy.

JOHN MAJOR

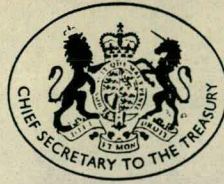
Annex

**ENGLISH ESTATES: FUTURE STRATEGY:  
DETAILED COMMENTS ON THE DRAFT WRITTEN ANSWER**

Page 1, 1st paragraph, last sentence [Managed Workspaces]. Future resources for the managed workspace programme are a matter for the Survey. The sentence should therefore be ended after the word "role".

Page 3, 1st complete paragraph, last sentence [English Estates' residual Development Role]. I suggest that you add to the end of this sentence text along the lines of: "and where public sector intervention does not represent a threat to the expansion of the free market".

Page 4, last paragraph, last sentence [English Estates' forward plan - geographical boundaries]. It would be useful to make clear that it is your intention that the geographical boundaries of English Estates' operation should be narrowed over time.



2 EX Sir Mowlem, Mr Hanson,  
 Mr Mank, Mr Walker, Mr Burgess  
 Mr Stevens, Mr Tombs,  
 Mr Mac Anslan, Mr Richardson,  
 Mr Williams, Mr Mayrick,  
 Mr Remberg, Mr Osmond,  
 Mr Ellis, Mr Carr

Treasury Chambers, Parliament Street, SW1P 3AG

18 July 1988

The Rt Hon The Lord Young of Graffham  
 Secretary of State for Trade and Industry  
 1-19 Victoria Street  
 LONDON SW1

Dear David,

*Handwritten notes in red ink:*  
 We want to  
 make the withdrawal  
 as complete as possible. There is  
 a strong case for  
 a withdrawal  
 - was a  
 Howard  
 date

**ENGLISH ESTATES : FUTURE STRATEGY**

Thank you for your letter of 11 July 1988.

The role of English Estates is to provide factory premises only where there is clear evidence of market failure, and where State provision does not run the risk of perpetuating that market failure. I therefore welcome your decision to take steps to ensure that English Estates operate within that framework by pursuing a withdrawal strategy. It is sensible to ensure that English Estates withdraw from areas where the market could provide premises, or where English Estates' continuing intervention is likely to delay further the return of market operators.

However, it is too early to take decisions on the withdrawal strategy without looking in detail at the arrangements for ensuring its success in the context of English Estates' corporate plan. Consequently, any public statement that was made at this stage would have to be consistent with a wide range of possible outcomes for decisions on the details of the withdrawal strategy. In particular, future levels of resources for English Estates are a matter for the Survey.

On that understanding, I am content with the draft written answer you propose, subject to the drafting changes annexed to this letter. It follows that nothing said subsequently in elucidation of the statement should go beyond the terms agreed before I have had the chance to consider your detailed proposals on the implementation of the withdrawal strategy.

Yours faithfully,  
  
 JOHN MAJOR

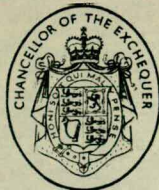


**ENGLISH ESTATES : FUTURE STRATEGY:  
DETAILED COMMENTS ON THE DRAFT WRITTEN ANSWER**

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Page 4, last paragraph, last sentence [English Estates' forward plan - geographical boundaries]. It would be useful to make clear that it is your intention that the geographical boundaries of English Estates' operation should be narrowed over time.



FROM: J M G TAYLOR  
DATE: 25 July 1988

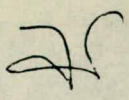
PS/CHIEF SECRETARY

cc Sir P Middleton  
Mr Anson  
Mr Monck  
Mr Burgner  
Mr Turnbull  
Mr MacAuslan  
Mr Richardson  
Mr Waller  
Mr Meyrick  
Mr N Williams  
Mr Romberg  
Mr Osmond  
Mr Ellis  
Mr Call

**ENGLISH ESTATES: FUTURE STRATEGY**

The Chancellor has seen Mr Romberg's submission of 14 July, and the Chief Secretary's letter of 18 July to Lord Young.

2. He has commented that we want to make the withdrawal as complete as possible. There is a strong case for announcing - now - a terminal date.

  
J M G TAYLOR

It would not be possible to insert a terminal date or dates into the proposed statement without substantially altering the nature of that statement in ways which would be unacceptable to DTI Ministers  
Neil Williams  
26/7

1. Mr Neil Williams
2. Mr Waller
3. Chief Secretary

From: Michael Romberg

26 July 1988

File IRARD J/7

cc PS/ChEx

Sir Peter Middleton  
Mr Anson  
Mr Monck  
Mr Burgner  
Mr Turnbull  
Mr MacAuslan  
Mr Richardson  
Mr Meyrick  
Ms Osmond  
Mr Ellis  
Mr Call

## ENGLISH ESTATES: FUTURE STRATEGY

### Summary

1. English Estates build factories in the assisted areas. On 11 July 1988, Lord Young sought your consent to a draft statement announcing preliminary consideration of a withdrawal strategy under which English Estates would progressively leave factory building to the private sector (my submission of 14 July 1988 gives background). Your reply of 18 July 1988 agreed to the statement subject to changes designed to maintain your position in the Survey and emphasising the withdrawal elements. DTI have accepted your points.

2. Mr Taylor wrote on 25 July 1988 recording that the Chancellor wished for a terminal date to be announced now. DTI are to make their statement later this week. On the information currently available, no terminal date could be set at this stage. I therefore recommend that you should not seek to alter the terms of the statement. But it would be useful to get the thought across to DTI so that the English Estates corporate plan promised in the summer recess will include the setting of dates for those areas where continued activity is envisaged for the present. A draft letter is attached.

### Background

3. English Estates build factories in the assisted areas. The withdrawal strategy would divide these areas into three:

(i) Where yields were already good enough, English Estates would leave provision to the market.

(ii) Where yields could soon be good enough, English Estates would increase rents and lever in the private sector through rental guarantees, with total English Estates withdrawal to follow.

(iii) Where there was no prospect of yields approaching those required by the private sector soon, English Estates would continue to undertake direct provision, but would raise rents and hope to move these areas gradually into category (ii).

4. The DTI statement gives an outline of this approach. The statement is an early announcement, made now to deal with problems of staff morale and criticisms of inadequate building in the North East. The revised text, annexed under Phillips' letter of 25 July 1988 to Waller (copy attached), meets the points you made in your letter of 18 July 1988. In particular the concluding sentence refers to the geographical boundaries of the areas of direct provision being expected 'to narrow significantly over time'.

5. Mr Taylor wrote on 25 July 1988 recording that the Chancellor wanted to make the withdrawal as complete as possible. He saw a strong case for announcing now a terminal date.

6. As yet, English Estates have not done the work which would enable a date to be set either for the termination of the assisted areas programme as a whole or for the phases of the withdrawal strategy. Nor would such a definite declaration sit easily in what is very much a preliminary statement of the approach to be adopted.

7. But it would be worth emphasising to DTI that English Estates' corporate plan, expected in about September 1988, should come up with firm proposals on dates. The attached draft letter makes that point.

MR

Michael Romberg  
IAE2  
270 4662  
Rm 114/G

DRAFT LETTER FROM CST TO LORD YOUNG  
(draft of 26 July 1988)

**ENGLISH ESTATES: FUTURE STRATEGY**

1. I am grateful to you for accepting the changes that I suggested on 18 July 1988 to the terms of the draft written answer announcing your future strategy for English Estates.
2. There is one additional important point that I would wish to see covered in English Estates' corporate plan due later this year.
3. It is important to give the private sector every confidence in the withdrawal strategy. An essential element in boosting confidence and enabling the private sector to prepare itself for a greater role, is the need to announce well in advance the dates for the progressive narrowing of the boundaries of English Estates' direct provision.
4. I should therefore be grateful if you would ensure that the English Estates 1988 Corporate Plan covers not only their immediate withdrawal from areas where the private sector could take over now, but also the setting of the dates for withdrawal from those areas where a facilitating or residual funding role is still thought necessary for the time being.

JOHN MAJOR

376e

costs OK Yes  
1. Mr. Hoyle <sup>mk</sup> 26/7/88  
2. file

M A Waller Esq  
HM Treasury  
R116G, Treasury Chambers  
Parliament Street  
LONDON SW1P 3AG

**Department of  
Trade and Industry**

Kingsgate House  
66-74 Victoria Street  
London SW1E 6SW

Switchboard  
01-215 7877

Telex 936069 DTIKH G  
Fax 01-931 0397

Direct line 01-215 2520  
Our ref  
Your ref  
Date 25 July 1988

*Dear Mike,*

**ENGLISH ESTATES: PARLIAMENTARY STATEMENT**

....

I enclose a copy of the final version of the statement on English Estates which DTI Ministers have amended to reflect the points in the Chief Secretary's letter of 18 July. An arranged question is being put down for answer tomorrow or on Wednesday.

*Yours sincerely,  
Jonathan Phillips*

**JONATHAN PHILLIPS**

JP2AEL



the department for Enterprise

## DRAFT PARLIAMENTARY STATEMENT: EIEC

As the White Paper, 'DTI - the department for Enterprise', Cm 278, made clear, the activities of English Estates are an important instrument of our policies which seek to support economic development and encourage enterprise in the regions and inner cities. The recently launched programme aimed at increasing the supply of managed workspace in the inner cities has added an important new dimension to its role.

In the Assisted Areas the essential role of English Estates is to seek to ensure that suitable premises and sites are available to meet the needs of new and growing businesses which would not otherwise be met. It does this in a variety of ways including the development of factories, workshops and offices either in advance of demand or to meet the needs of specific customers. It also actively facilitates provision by private sector developers, investors and owner occupiers.

Improving economic conditions have enabled English Estates in recent years to achieve successive annual improvements in the amount of floorspace let and



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sold. There is, nevertheless, an unsatisfied demand for premises which, combined with rising rental levels and the prospect of continuing economic growth, is leading to renewed interest by the private sector in providing industrial and commercial floorspace in some parts of the Assisted Areas. If the property needs of industry and commerce are to be met, it is essential that this interest should be further encouraged. This requires a suitable response on the part of English Estates. We have, therefore, been considering with the Board of the Corporation how the planning and execution of its Assisted Areas programme should be developed.

On the basis of advice from the Board we have concluded that in order to reinforce existing market trends English Estates should adopt fresh approaches designed to secure increased private sector activity wherever possible.

This will affect English Estates' policies towards rental levels and sale prices. Hitherto, the general requirement has been that these should be set at the maximum level the market would bear. For the future English Estates will have the more specific objective of endeavouring to increase rents and sale prices to



levels which will make equivalent developments attractive to the private sector.

The emphasis of English Estates' development strategy will also change substantially with the aim of securing increased private sector activity. Thus English Estates role as a facilitator will assume much greater significance through the marketing of development opportunities, the preparation and disposal of serviced sites, joint ventures and the sale of completed schemes to investors. English Estates will only use its own development funding in the areas and for the products where private sector provision remains inadequate and where it will not impede the return to a properly functioning property market.

Thus in considering the shape of its future programme in the Assisted Areas English Estates will have regard to three categories of area and types of property. In the first, the presumption will be that the private sector will be meeting demand without the involvement of English Estates. In the second, it is likely that English Estates will need to participate in some form of joint venture in some types of development if private sector involvement is to be triggered. We shall consider with English Estates the



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cost-effectiveness of particular arrangements which may be necessary to encourage appropriate private sector provision. In the third, where there is no immediate prospect of private sector provision, English Estates will continue to act as a funder and developer, but on the basis of the rentals and sales policy outlined above.

In future I shall be determining the size of English Estates' annual development programme on the basis of advice from the Board about market demand, the likely level of private sector provision and the availability of public sector resources. I shall also take into account the need to balance the demand for resources between the Assisted Areas programme and the new inner city managed workspace programme as the latter develops. Decisions about which developments are to be undertaken will remain the responsibility of the Board acting within the framework I have just described. I have asked the Board to take steps to publish regularly a programme describing the projects planned to be pursued in each region in particular financial years. I shall expect the geographical boundaries of that programme to narrow significantly over time as they take full account of changing rental levels and development costs.