PREM 19/2301

MT

PART 33

CONFIDENTIAL FILING

RELATIONS BETWEEN CENTRAL AND LOCAL GOVERNMENT.
LOCAL AUTHORITY EXPENDITURE
LOCAL AUTHORITY ELECTIONS
ABOLITION OF GLC AND MCCS

LOCAL GOVERNMENT

PART 1: MAY 1979

PART 33: AUG 1987

PREM 19/2301

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
6.8.87		20.11.87					
~~7.8.87~~		~~23.11.87~~					
~~10.8.87~~		~~25.11.87~~					
~~12.8.87~~		~~27.11.87~~					
~~17.8.87~~		30.11.87					
~~27.8.87~~		[redacted]					
~~2.9.87~~							
~~11.9.87~~							
~~17.9.87~~							
~~21.9.87~~							
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8.10.87							
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~~29.10.87~~							
~~3.11.87~~							
~~9.11.87~~							
~~10.11.87~~							
~~17.11.87~~							

PART 33 ends:-

CST TO SS/DOE 30.11.47

PART 34 begins:-

SS/DOE TO LPC 3.12.47

002/3294

O10

CCBS

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

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

NRBM

30th November 1987

Dear Nick,

LOCAL GOVERNMENT FINANCE BILL: FEES AND CHARGES

I understand that the draft Bill (prepared for introduction before Christmas) does not include the provision extending local authorities' power to introduce fees and charges.

E(LF) decided in February that this primary legislation should be sought. It is very disappointing and puzzling to learn that it is not yet ready. I am even more concerned to learn that there is a risk that it may not be possible to introduce the necessary provisions during the passage of the Bill. I am sure you will be concerned at this, not least since greater use of fees and charges reduce the burden on local taxpayers and reduce public expenditure. We estimate that greater use of fees and charges could save around £50 - £100 million. I hope therefore that you can take the necessary steps to ensure that E(LF)'s decision is implemented as planned.

I am copying this letter to members of E(LF), First Parliamentary Counsel and Sir Robert Armstrong.

Yours Ever,
John

JOHN MAJOR

010

cc JG

Y SWYDDFA GYMREIG
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-270 3000 (Switsfwrdd)
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ODDI WRTH YSGRIFENNYDD
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WELSH OFFICE
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WHITEHALL LONDON SW1A 2ER
Tel. 01-270 3000 (Switchboard)
01-270 0549 (Direct Line)

FROM THE PRIVATE SECRETARY
TO THE SECRETARY OF STATE
FOR WALES

1. NSA
2 NBPM

Dear Steven

30 November 1987

WELSH RATE SUPPORT GRANT SETTLEMENT 1988/89

WILL REQUEST IF REQUIRED

Further to Keith Davies' letter of ~~17~~ November I now understand that the Department of the Environment propose to lay their Report and make a statement next Monday 30 November.

In view of this I thought it would be helpful if I confirmed our recent telephone conversations with your and the Chief Whip's office that we intend to lay the Welsh Report in the week commencing 7 December (Tuesday 8 December would be our preference) with an oral statement on the same day. The intention would then be to debate it during the following week if possible.

I am copying this to Andy Bearpark and the Chief Press Secretary's office at No 10, the Private Secretaries of E(LA) members, to Murdo MacLean and Rhodri Walters in the Chief Whip's office, and to Trevor Woolley in Sir Robert Armstrong's office.

Yours sincerely

John Shortridge

J D SHORTRIDGE

Steven Wood Esq
Private Secretary to the Rt Hon John Wakeham MP

STATEMENT BY SECRETARY OF STATE, MONDAY 30 NOVEMBER

RATE SUPPORT GRANT SETTLEMENT, ENGLAND, 1988/89

1. With permission Mr Speaker I should like to make a statement about the Rate Support Grant Report for 1988/89 which I have today laid before the House.

2. I announced to the House in July my proposals for the aggregates of local authority expenditure and grant for 1988/89. Subsequently, in October, I issued a consultation paper to local government containing details of all my proposals for next year's Rate Support Grant Settlement. The main elements of these proposals were

- that local authority current expenditure provision should be set at £27.538 billion, a 7% increase on the amount provided for 1987/88 allowing non-rate capped authorities to hold their spending broadly steady in real terms;

- that there should once again be a margin between the total of grant related expenditure and expenditure provision to reflect my view that authorities continue to spend more than they need;

- that Aggregate Exchequer Grant should be £13.775 billion, a cash increase of £750m or 5¾% on 1987/88, holding grant at 46.2% of relevant expenditure;

- that there should be no major changes in the mechanisms of grant distribution and only limited changes to the methodology for assessing needs;

- and finally that there should be a safety net equivalent to 5p at ratepayer level to prevent certain year-on-year grant losses and a cap of 10p at authority level to limit grant gains.

3. I have received comments on my proposals from the Local Authority Associations and about 175 local authorities. There has been a widespread welcome for the stability proposed in the mechanisms for distributing grant and the methodology for calculating grant related expenditure. Inevitably, I did not please everybody. There has been criticism of some aspects, in particular the provision for expenditure, and of the effect of the proposals on certain authorities.

4. I have considered all the comments very carefully, and have considered that my proposals struck the right balance, subject to some minor changes of data. Accordingly I have laid the Report today.

5. Within the existing Rate Support Grant System, I believe that the settlement provides realistically for expenditure whilst making clear that the Government is not prepared to underwrite high spending and high wage increases. It includes a generous

cash increase in the taxpayers' contribution to the running of local services. And as I have already indicated it maintains as much stability as possible in this the penultimate year of the present system.

6. In reaching my decisions I have had particularly in mind the effect of my proposals for ratepayers. This settlement means that rate bills need on average increase by no more than the rate of inflation, but I must stress that there can be significant variations around the average. Clearly the actual level of rates will depend on the budgets of each individual local authority. I hope however that authorities will take advantage of the many opportunities open to them to increase efficiency and make savings so as to keep rates down.

7. I will be making a separate announcement on rate limits and on the expenditure levels of those authorities which have sought redetermination next month.

cc BG

From: THE PRIVATE SECRETARY

HOME OFFICE
QUEEN ANNE'S GATE
LONDON SWIH 9AT

27 November 1987

Dear Robin,

RATE SUPPORT GRANT SETTLEMENT
1988/89

flap

Thank you for letting us see the draft oral statement your Secretary of State proposes to make on Monday. We are content with the text.

Copies of this letter go to the recipients of yours.

Yours sincerely,

Philip Mawer

P J C MAWER

R U Young, Esq.,

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

27 November 1987

RATE SUPPORT GRANT SETTLEMENT 1988/89

The Prime Minister has seen your letter to me of 24 November to which was attached a draft of the statement your Secretary of State proposes to make on Monday about the Rate Support Grant 1988/89 and is content, subject to the views of colleagues.

I am copying this letter to the Private Secretaries to members of E(LA), Murdo Maclean and Rhodri Walters (Chief Whips' offices) and to Trevor Woolley (Cabinet Office).

D. R. Norgrove

R Young Esq.,
Department of the Environment.

CONFIDENTIAL

CCBG

HOME SECRETARY

QUEEN ANNE'S GATE LONDON SWIH 9AT

27 November 1987

Dear Secretary of State,

VRAM

PASSENGER TRANSPORT AUTHORITIES UNDER THE NEW LOCAL GOVERNMENT FINANCE REGIME

flap

I have seen Nicholas Ridley's reply to you of 23 November agreeing to change the status of PTAs from precepting to billing authorities in the new local government finance legislation.

I am content with this provided the decision can be presented and argued in terms which do not raise difficulties for the joint police and joint fire and civil defence authorities. In particular, I would not wish to see you stress the need to improve "accountability" in a way which might cast doubt on the degree of accountability which exists for the police and the fire services. I am sure you will understand that this is a sensitive area (for the police service in particular).

I would prefer, therefore, that your case focussed on the need to encourage district-based arrangements for transport, which no doubt underlies Nicholas Ridley's points about secession. This is not however a practicable proposition as far as the joint police or joint fire and civil defence authorities are concerned.

I am copying this ~~letter~~ to the ~~Prime~~ Minister, Members of E(LF), Sir Robert Armstrong and the Chief Whip.

Yours sincerely,

Ne Jenkyn

(approved by the Home Secretary and signed in his absence)

The Rt Hon Paul Channon, MP

CONFIDENTIAL

local gov. Relations p 33

015/4212

010

CCBG

Treasury Chambers, Parliament Street, SW1P 3AG

R U Young Esq
Private Secretary to the
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
London
SW1P 3EB

NBBN.

27 November 1987

Dear Robin,

RATE SUPPORT GRANT SETTLEMENT 1988-89

The Chief Secretary has seen the draft statement attached to your letter to David Norgrove of ~~24~~ November. As I warned you he has one comment. WITH DN!

The Chief Secretary is unhappy with the emphasis given in paragraph 3 of your statement to the "maintenance of the grant percentage". The Chief Secretary would wish your Secretary of State to delete this, although he has no objection to the other references to the grant mechanisms. As you know from previous correspondence between the Chief Secretary and your Secretary of State, the Chief Secretary believes that emphasising the grant percentage in this way is tantamount to telling local authorities that the Government is indeed prepared to underwrite the high wage increases that they cede to their workforce - directly contradicting the assertion in paragraph 5 of your statement that the Government is not prepared to underwrite high spending and high wage increases.

Otherwise the Chief Secretary is content.

I am copying this to David Norgrove (No. 10), to the Private Secretaries of E(LA) members, to Murdo MacLean and Rhodri Walters in the Chief Whips' offices, and to Trevor Woolley in Sir Robert Armstrong's office.

Yours,

Jill

JILL RUTTER
Private Secretary

CC3C

CONFIDENTIAL

Reference No E 0450

MR NORGROVE

cc Mr Wilson

E(A): Major construction projects

On 7 May E(A) considered a paper by Mr Ridley on ways of reducing delays to major construction projects. The Prime Minister asked him to return to the Committee 'with further proposals later in the year in the light of urgent interdepartmental consideration' of those he had made.

2. DOE now tell us that the interdepartmental consideration has taken longer than they thought, and they do not expect to be able to put proposals to E(A) before the end of 1987, as the Prime Minister asked. If you agree, we shall accept this , and look for a discussion in January. DOE have said they hope to be ready by then.

G W MONGER

Cabinet Office
25 November 1987

M Monger
Thank you. But we should not allow this to slip too far. I suggest this is a topic, rather awkward, which could slip to the Greek kalends.

26/11.

CONFIDENTIAL

010

SSLG
cc BT

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

David Norgrove Esq
Private Secretary to
The Prime Minister
10 Downing Street
LONDON
SW1A 2AA

Prime Minister' Content? HCS 24/11.

24 November 1987

Yes mr

Dear David,

RATE SUPPORT GRANT SETTLEMENT 1988/89

I enclose a draft of the oral statement my Secretary of State proposes to make on Monday 30 November. Lord Belstead will repeat it in the Lords.

The consultation paper included a proposal that the settlement should be based on information up to a cut-off date. A number of changes to the data on which the consultation paper was based have come to light since the paper was issued and this information is taken into account in the settlement. The only change of any significance is to Colchester's transport GRE which in turn affects the GREs of other Essex districts and Essex County Council. As a result the county will get £0.72m less than in the consultation paper - although it still receives about £15m more than last year and £124m in total: the Essex shire districts receive more grant.

I should be grateful if any amendments or comments could reach me by lunch on Friday 27 November.

I am copying this letter and attachment to the Private Secretaries of E(LA) Members, to Murdo Maclean and Rhodri Walters in the Chief Whips' offices, and to Trevor Woolley in Sir Robert Armstrong's office.

Yours,

RUY.

R U YOUNG
Private Secretary

100% RECYCLED PAPER

DRAFT STATEMENT

1. With permission Mr Speaker I should like to make a statement about the Rate Support Grant Report for 1988/89 which I have today laid before the House.

2. I announced to the House in July my proposals for the aggregates of local authority expenditure and grant for 1988/89. Subsequently, in October, I issued a consultation paper to local government containing details of all my proposals for next year's Rate Support Grant Settlement. The main elements of these proposals were

- that local authority current expenditure provision should be set at £27.538 billion, a 7% increase on the amount provided for 1987/88 allowing non-rate capped authorities to hold their spending broadly steady in real terms;

- that there should be a margin between the total of grant related expenditure and expenditure provision to reflect my view that authorities continue to spend more than they need;

- that Aggregate Exchequer Grant should be £13.775 billion a cash increase of £750m or 5¾% on 1987/88, holding grant at 46.2% of relevant expenditure;

- that there should be no major changes in the mechanisms of grant distribution and only limited changes to the methodology for assessing needs;

- and finally that there should be a safety net equivalent to 5p at ratepayer level to prevent certain year-on-year grant losses and a cap of 10p at authority level to limit grant gains.

3. I have received comments on my proposals from the Local Authority Associations and [120] local authorities. There has been a widespread welcome for the maintenance of the grant percentage, and the stability proposed in the mechanisms for distributing grant and the methodology for calculating grant related expenditure. Inevitably, I did not please everybody. There has been criticism of some aspects, in particular the provision for expenditure, and of the effect of the proposals on certain authorities.

4. I have considered all the comments very carefully, and have considered that my proposals struck the right balance, subject to some minor changes of data. Accordingly I have laid the Report today.

5. Within the existing Rate Support Grant System, I believe that the settlement provides realistically for expenditure whilst making clear that the Government is not prepared to underwrite

high spending and high wage increases. It includes a generous cash increase in the taxpayers' contribution to the running of local services. And as I have already indicated it maintains as much stability as possible in this the penultimate year of the present system.

6. In reaching my decisions I have had particularly in mind the effect of my proposals for ratepayers. This settlement means that rate bills need on average increase by no more than inflation, but I must stress that there can be significant variations around the average. Clearly the actual level of rates will depend on the budgets of each individual local authority. I hope however that authorities will take advantage of the settlement I have made and of the many opportunities open to them to increase efficiency and make savings so as to keep rates down.

7. I will be making a separate announcement on rate limits and on the expenditure levels of those authorities which have sought redetermination next month.

CONFIDENTIAL

cc BG

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

The Rt Hon Paul Channon MP
Secretary of State
Department of Transport
2 Marsham Street
LONDON
SW1P 3EB

23 November 1987

NBPM

Dear Paul

PTAs UNDER THE NEW LOCAL GOVERNMENT REGIME

Thank you for your letter of 23 October.

I accept your view that abolition of PTAs is not an immediate option though we must retain that as a longer term objective. We are therefore left with your proposal to change the status of PTAs from precepting to billing authorities.

I remain concerned that your proposed change will improve accountability only if secession is perceived as a real option by metropolitan districts. I can therefore agree to the change only on the understanding that this point is highlighted and that every encouragement is given to metropolitan districts to secede. On that basis I am content for our officials to sort out the necessary changes to the Local Government Finance Bill, which will have to be introduced in Committee.

I am copying this letter to the Prime Minister, other members of E(LF) and Sir Robert Armstrong, and the Chief Whip.

Yours ever

Nicholas

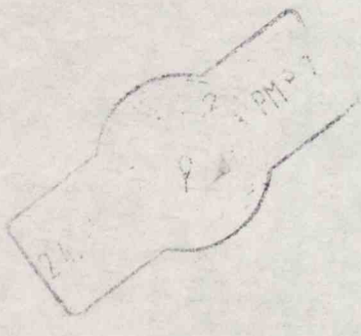
NICHOLAS RIDLEY

This is 100% recycled paper

LOCAL GOVT

RELATIONS

PT 33



005/4208

CC BC

Treasury Chambers, Parliament Street, SWIP 3AG

The Rt Hon Viscount Whitelaw PC CH MC
Lord President of the Council
Privy Council Office
Whitehall
London
SW1A 2AT

Dear Willie,

23 November 1987

NEW BURDENS ON LOCAL GOVERNMENT

Nicholas Ridley wrote to you on 19 October with the latest list of initiatives by central government that affect local authorities. I note that once again we have continued to add new burdens to local authorities over the last six months.

I very much support his view that we should continue the new burdens procedures. I think we are all aware of the pressure new policy initiatives can place upon local government expenditure. Despite all our efforts, local authority spending has risen by 10 per cent in real terms over the past two years. Recent pay rises will keep the pressure up. Devolving responsibilities to local government cannot help and may indeed fuel increased spending.

We must accept that for the present our controls over local government spending are very much less effective than our powers over central government programmes. I therefore take the view it is essential for departments to follow the agreed rules for new burdens in full. In particular, we must stick to the requirement that offsetting savings be identified on central government programmes where the cost of a new burden on local authorities exceeds £100,000.

I am copying this letter to the Prime Minister, members of E(LA) and Sir Robert Armstrong.

Yours Ever,
John

JOHN MAJOR

LOCAL GOVT

RELATIONS

PT 33

RESTRICTED

FCS/87/243

Chief Secretary

Grants from the European Community in respect of Current Expenditure by Local Authorities

1. I was interested to see your letter of 3 November to Nicholas Ridley about ERDF Article 15 applications.

2. When Labour Members of the European Parliament raised this subject at Strasbourg on 27 October, Commissioner Schmidhuber confirmed, and regretted that the UK was still only making limited use of Article 15. There is evidence that the Commission may in fact try to force the issue by refusing to accept applications for Integrated Operations unless they include Article 15 components. Since we currently have four such applications outstanding, worth in all nearly £700 million in terms of ERDF and Social Fund grants, we would do well to conclude our internal debate on Article 15 receipts very quickly.

3. I therefore welcome your latest proposal. I assume that your cumulative £5 million limit would apply only to new receipts; and hope that Nicholas Ridley and others will agree to settle the matter on that basis.

4. I am copying this minute to the Prime Minister, Nicholas Ridley, David Young, Kenneth Clarke, Peter Walker, Malcolm Rifkind, Tom King, Norman Fowler and to Sir Robert Armstrong.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
22 November 1987

RESTRICTED

cc BF.

HOME SECRETARY

QUEEN ANNE'S GATE LONDON SWIH 9AT

20 November 1987

1600pm

Dear Nicholas,

LOCAL GOVERNMENT BILL: HOMOSEXUALITY AMENDMENT

Thank you for sending me a copy of your minute of 16 November to the Prime Minister.

I welcome the principle of the amendment and your proposals for handling it.

It is of course already an offence for anyone, including a local authority, to incite counsel or procure another person to commit a homosexual act prohibited by law (for example, with a person under 21). I am anxious not to get drawn along the path of extending the criminal law to proscribe the mere expression of opinion. Your proposals do not, of course, call on the criminal law. It would help, however, if the arguments for the amendment could be presented in terms of the proper limits of the functions of local authorities and not in terms which would make it difficult to resist the creation of a general criminal offence.

With this point in mind, I should be grateful to be kept in touch with developments, including sight of your redraft in due course.

I am copying this letter to the Prime Minister, members of H and L Committees, the Minister for the Arts, Sir Robert Armstrong and First Parliamentary Counsel.

Yours,

Douglas.

The Rt Hon Nicholas Ridley MP.

LOCAL GOVT: Relations PT33

010/4210

CONFIDENTIAL

cc BG

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

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

NBAG

20 November 1987

Dear Secretary of State,

"STOP" POWER FOR THE DISTRICT AUDITOR

I have seen a copy of your minute of 19 November to the Prime Minister setting out revised proposals for stopping local authorities entering into creative financing deals.

I very much support the principle of preventing local councils accumulating further spend-now, pay-later commitments through creative financing. I recognise however that further work in this area is needed to try and develop self-regulation and statutory schemes - not least on the definition, interpretation and statistical robustness of the prudential ratios. As this work develops, we will be better able both to determine whether the self-regulation and statutory schemes are likely to be practicable, and if so to judge whether the statutory scheme might be introduced at the outset. We should look again at the respective merits of these options in E(LF) once the position on prudential ratios and other aspects is clarified.

In the meantime, however, we face a hiatus - possibly until the new capital control regime can come into effect - with inadequate powers to prevent creative financing deals in general. I appreciate that the flow of such deals appears to have slowed down in recent months. But small changes in the political balance on certain councils could quickly renew their interest in creative financing.

I believe that we must take action on specific types of creative financing where we can. I understand we can make it more difficult for local authorities to arrange

LOCAL GOVT: Relations PT33

23 JUL 10 AM '87

CONFIDENTIAL

some types of sale and leaseback deals if we bring property leases of less than twenty years within the scope of the existing capital control system. I hope you will therefore agree to do so. We should look again at interest rate swaps once the Haringey Court case has clarified the legal position. But whatever steps prove practicable to limit particular types of deal, we also need to take a high profile in public pronouncements in opposing further creative financing. Moreover we should encourage the Audit Commission to continue publicising the need for prudent financial conduct by local councils, and to reinforce their condemnation of spend-now pay-later deals, as financially irresponsible.

In the meantime, the work on developing practical schemes to promote prudent financial conduct needs to go forward quickly; I would wish my officials to be involved in this exercise.

I am copying this letter to the Prime Minister and other members of E(LF) and to Sir Robert Armstrong.

Yours sincerely,

Jim Ruth

pp JOHN MAJOR

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

011/4210

010

CONFIDENTIAL

CCSG

Treasury Chambers, Parliament Street, SW1P 3AG

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

NBPM.

20 November 1987

Dear Secretary of State,

DOE/LA1 END-YEAR FLEXIBILITY

WILL REQUEST IF REQUIRED

Thank you for your letter of 21 October proposing that we should announce extra capital allocations for local authorities for 1988-89, under the end-year flexibility (EYF) rules, because of the likely underspend on the relevant cash limit DOE/LA1 in 1987-88. I have also considered Kenneth Baker's and Paul Channon's letters supporting your proposal.

The forecast underspend on DOE/LA1 this year does not arise from any shortfall in gross capital spending; on the contrary, total expenditure is projected to exceed gross provision. Rather the underspend stems from higher capital receipts, a reflection of the success of our policies in encouraging asset sales. In the circumstances, I am reluctant to concede higher capital provision for local authorities in 1988-89 than we agreed in the Survey and announced earlier this month.

However I understand your Department's lawyers advise that the wording of the relevant DOE circular 5/87 in effect requires us to increase the amount available for allocation the following year if we take the view in the autumn that an underspend is likely. The implied lack of Ministerial discretion is highly unsatisfactory; and in view of this advice, we will need to consider the rules for EYF on this cash limit further.

But the immediate difficulty is that local authority associations are now aware of the projected underspend on DOE/LA1 in 1987-88. I do not believe there is a case on merits for going beyond the total gross provision for LA capital announced in the Autumn Statement; but we clearly need to take into consideration the risk identified by your Department's lawyers of successful legal challenge if we do not acknowledge that the EYF arrangements set out in the circular will apply.

I am reluctantly driven to the conclusion that, on balance, it is probably better to accept that the principle of EYF will apply than to risk successful legal challenge. But before confirming my agreement to this, I have two particular concerns on which I would wish to be satisfied. These relate to the maximum amount of extra allocations under EYF, and the timing of their announcement.

In setting the amount we need to take into account the small overspend on the cash limit in 1986-87. Paragraph 61 of Circular 5/87 recognises that where the size of the breach is uncertain at the end of the year, the cash limit penalty may be applied a year later. I therefore propose that the £18.5 million overspend in 1986-87 should be netted off the EYF figure for 1987-88. Also these extra allocations will be a charge on the 1988-89 Reserve and effectively an in-year change. The rule is therefore that each £1 allocation should score as £1 on provision and the cash limit (not at the higher rates of allocations to provision used in the Survey). Accordingly when the amount available for allocations in 1988-89 under EYF is announced it should be on the basis of a 1:1 ratio between cash limit provision and allocations. At its maximum it would therefore mean an additional amount for allocation of £123.2 million (5 per cent of EYF 1987-88 equal to £141.7 million less £18.5 million overspend in 1986-87).

We also need to consider the distribution of the revised total of allocations to service blocks. In this context, we need to keep in mind the need to make provision for capital spending falling in 1988-89 to remedy storm damage. Within this total, I therefore propose that you set aside a sum sufficient to cover allocations needed for this purpose. You and colleagues in departments will be best placed to judge what this amount should be on the basis that I will not be willing to agree any further allocation subsequently. The remainder of the £123 million should be distributed to departments in proportion to net provision.

Finally, on timing, you will appreciate that the Chancellor and I are bound to be very concerned about any announcement which implies a significant claim on the Reserve in advance of publication of the Public Expenditure White

Paper, planned for mid-January. We must avoid the embarrassment of being seen to raid our own Reserve before the figures are published. I should be grateful therefore if you would defer an announcement of the precise figures for extra allocations and their distribution, until after publication of the White Paper. You will in any case wish to consider the second quarter figures and allocations for storm damage before agreeing the final figures.

I very much hope you can meet my concerns about timing, and that you and colleagues are content with what I propose on the amount and distribution of extra allocations. If so, I for my part would be prepared to accept that the principle of EYF should apply to the expected underspend this year, and that if necessary you should indicate this publicly in responding to questions that may arise from the first quarter figures.

I am copying this letter to Willie Whitelaw, other members of E(LF) and Sir Robert Armstrong.

Yours sincerely,

John Major

pp JOHN MAJOR

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

Cite SRW
cc BG

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

17 November 1987

Dear Robin

LOCAL GOVERNMENT BILL: HOMOSEXUALITY AMENDMENT

The Prime Minister has seen your Secretary of State's minute of 16 November on the above subject. Subject to the views of colleagues, she is content with his proposal to accept the principle of Jill Knight's amendment, and to redraft a revised version as proposed.

I am copying this letter to the Private Secretaries to members of H and L Committees, the Minister for the Arts, the First Parliamentary Counsel, and to Sir Robert Armstrong.

Yours ever

Andy

(P. A. BEARPARK)

Robin Young, Esq.,
Department of the Environment.

010

cc BG

SECRETARY OF STATE FOR THE ENVIRONMENT

Prime Minister Yes

Content, subject to colleagues, with N Ridley's proposed handling?

Prime Minister

LOCAL GOVERNMENT BILL: HOMOSEXUALITY AMENDMENT

16/10

You will remember that last session Jill Knight took up Lord Halsbury's Bill to prevent local authorities promoting homosexuality, but that the Opposition by a procedural device prevented it making progress.

At Questions on 14 May you expressed regret at this, and hoped that Jill would successfully bring the Bill back this Session. She has now done so in the form of an amendment to the Local Government Bill (a copy is attached).

The purpose of this minute is to seek your, and colleagues', agreement to my proposed handling.

I should like to accept the principle of the amendment, but to take steps to remedy detailed drafting defects in the provisions. Although we would have accepted the form of last Session's Bill under the pressure at the end of a Parliament, the Bill (which is reproduced in the amendment) had two major defects:

i. it could be read as unreasonably preventing local authorities targeting any service on the homosexual community: this could pose problems in relation to, for example, AIDS; and

ii. the enforcement provisions duplicate, in different words, but with no real difference, the normal judicial review procedure: this is confusing, and might cast doubt on the effectiveness of that procedure elsewhere.

I would like, therefore, both to redraft the main provision to achieve a more objective, better targeted test, that would stop the abuses without preventing legitimate activities, and to drop

the special enforcement provisions. A preliminary discussion between Michael Howard and Jill Knight has shown that she is prepared to discuss a redrafted clause along those lines, but that she will want to examine it carefully before making any commitment.

If we accept this ban on the promotion of homosexuality, we may face pressure from the back-benches for a more radical response to abuses of discretionary spending powers by local authorities. I would propose to resist these, on the grounds that they are different in kind from the moral question raised by homosexuality; and that, raising questions of much greater scope, they would tend to delay the current Local Government Bill.

I should therefore be grateful for agreement to accept the principle of Jill Knight's amendment and to redraft a revised version to meet the points in paragraph 4 above. We would make it clear that this revised version is not likely to be available until the House of Lords.

I am sending a copy of this minute to members of H and L Committees, to the Minister for the Arts, to First Parliamentary Counsel, and to Sir Robert Armstrong.

N R

16 November 1987

Local Government Bill, continued

Prohibition on promoting homosexuality by teaching or by publishing material

Dame Jill Knight
Mr Barry Field
Mr Irvine Patrick
Mrs Teresa Gorman
Mr David Evans
Mr David Shaw
Mr Robert Hughes

To move the following clause: NC 14

'The following section shall be inserted after section 2 of the Local Government Act 1986 (prohibition of political publicity).

"Prohibition on promoting homosexuality by teaching or by publishing material

2A. - (1) A local authority shall not -

(a) promote homosexuality or publish material for the promotion of homosexuality;

(b) promote the teaching in any maintained school of the acceptability of homosexuality as a pretended family relationship by the publication of such material or otherwise;

(c) give financial or other assistance to any person for either of the purposes referred to in paragraphs (a) and (b) above.

(2) A breach of the prohibition referred to in subsection (1) above shall be justifiable in the civil courts in which interim relief may be granted on such terms as may be adjudged to be just and expedient.

(3) Without derogation from the right of any person having a sufficient interest to institute proceedings referred to in subsection (2) above, any parent, guardian or other person having custody of, or access to, any pupil in attendance at any such school shall be entitled to institute such proceedings.

(4) A local authority which in the opinion of the court has given appropriate instructions and taken reasonable steps to ensure compliance with the provisions of subsection (1) above may not be held to be in breach of the prohibition under subsection (2) above if such instructions have been disregarded and such steps have been ineffective to secure compliance.''.

CONFIDENTIAL

File · MJ

SUBJECT
CC MASTER

CC BG

10 DOWNING STREET
LONDON SW1A 2AA

10 November 1987

From the Private Secretary

Dear Alex,

A NEW PLANNING TOTAL

The Prime Minister this morning held a meeting to discuss proposals for a redefinition of the public expenditure planning total. There were present the Lord President, the Chancellor of the Exchequer, the Secretary of State for the Environment, the Chief Secretary and Mr Richard Wilson, Cabinet Office.

The Chancellor of the Exchequer said that the present planning total included local authority expenditure even though this was not within the control of central government. The public expenditure control system would be better and clearer if the planning total were to include grant paid by central government to local authorities rather than local authority expenditure itself. The change could be made in 1990, together with the proposed reforms of local authority finance. Total local authority expenditure would remain within General Government Expenditure which formed the numeraire for public spending as a proportion of GDP, the main figure on which the Government judged the success or failure of its public expenditure policies. The advantages of the change should not be exaggerated. But presentation would be improved and there would also be a modest but worthwhile improvement in public expenditure control.

The Lord President and the Secretary of State for the Environment warmly welcomed the Chancellor's proposal. Mr Ridley noted that three aspects would require further consideration: the treatment of local authority capital expenditure, whether expenditure financed by the national non-domestic rate should be inside or outside the planning total, and the handling of other spending departments which under the new system would be unable to make (spurious) claims about the amount of money being provided for particular local authority services. The Chancellor said his instinct was that expenditure financed by the national non-domestic rate should be within the planning total.

CONFIDENTIAL

The Prime Minister expressed her support for the principle of the change but was concerned that to make an early announcement would signal to the local authorities a weakening of determination to maintain control of expenditure in the period before the community charge was introduced. Mr Ridley suggested that the most vulnerable time would be the year 1989-90. The Rate Support Grant settlement for that year would need to be fairly tight.

After further discussion it was agreed that the Chancellor of the Exchequer should circulate a note on the latest timetable for consultation and decision which would allow the change of definition to be made in April 1990. Consultations within Government should also not take place until the last possible moment.

I am copying this letter to Mike Eland (Lord President's Office), Jill Rutter (Chief Secretary's Office) Robin Young (Department of the Environment) and Trevor Woolley (Cabinet Office).

Yours,
David.

David Norgrove

A.C.S. Allan, Esq.,
HM Treasury.

CONFIDENTIAL

Prime Minister

E(LF): "STOP" POWER FOR THE DISTRICT AUDITOR

E(LF) on 3 November raised a number of points about my proposal for a reserve power to impose prudential ratios. My more limited proposal to enable the District Auditor to act pre-emptively against unlawful or improper conduct, instead of having to wait until after the event, was agreed in correspondence in the summer.

We agreed last week that the development of prudential ratios should be as swift as possible. The two constraints are that rules to self-regulation have to be developed through full public discussions; and that workable ratios will have to be based on the approved accounting practice introduced into the local authorities this year. The first full set of improved accounts become available in Autumn 1988. April 1989 is therefore the earliest practicable date to have prudential ratios in effect.

I suggest therefore that we postpone legislation on that until the 1989/90 session. The reserve power that I proposed could still be effective during the 1989/90 financial year if we legislated for it then rather than in the current Local Government Bill. That timetable would allow us to see more clearly the emerging detail of the prudential ratios next Spring. I suggest we take the paper that I promised for E(LF) at that time.

If we legislate in the next session, the relation between prudential ratios and our capital controls will also be evident. The new capital controls will be designed as far as possible to remove the advantages of creative accounting. However these are annual controls and will not in themselves be a complete guarantee of prudent financial behaviour by authorities.

CONFIDENTIAL

The prudential ratios will therefore reinforce them by acting to prevent individual authorities accumulating spend-now, pay-later commitments.

In the meantime I believe it is important not to miss the opportunity of legislating in the Local Government Bill on the more limited proposal to enable the District Auditor to act pre-emptively against unlawful or improper conduct. I am therefore initiating a short period of public consultation on this aspect alone with a view to introducing provisions into the Local Government Bill at Commons Report.

Copies of this minute go to the other members of E(LF) and to Sir Robert Armstrong.

pp N R

9 November 1987

(Approved in draft by the Secretary of State and signed in his absence.)

PRIME MINISTER

A NEW PLANNING TOTAL

The Chancellor, supported by Mr. Ridley, proposes that the public expenditure planning total should now include the grant which central Government gives to local authorities rather than local authority expenditure itself. Local authority expenditure would of course still remain part of general Government expenditure, which is the definition operated by the CSO. (This forms the numeraire in the figures for public expenditure as a proportion of GDP.) Thus in a sense local authority expenditure would be treated statistically rather in the way debt interest is now. But in contrast to debt interest there would be pressures for lower local authority expenditure from the community charge and capping. (The Chancellor has accepted that the new system should only come into effect in April 1990, with the community charge.)

The change would have a number of advantages:

(i) the planning total would then comprise only those elements for which central Government is directly responsible;

(ii) it would bring out more clearly the amount of money which Government gives to local authorities;

(iii) it would be clearer to the local electorate who was responsible for increases in local taxation;

(iv) it would help stop grant being determined by previous years' overspending.

The change would also have attractions for local Government. Grants would be planned for three years ahead, not just one as at present, and local authorities would therefore have a better basis on which to plan their finances.

Spending Ministers would probably not welcome such a change, because it would show for example just how little money is within the gift of the DES. But from the overall Government point of view that would probably be no bad thing, and it would also cut out the annual shadow-boxing where Ministers argue about the allocation of expenditure to local authority services, which matters only presentationally, because the actual distribution of expenditure is largely determined by the local authorities not central government.

The main point on which you will want to satisfy yourself is that the change can be made without giving a signal that the Government is less concerned now about controlling local authority expenditure. On balance it seems to me that the merits of the change, combined with the pressure which will be exerted by the community charge, make this risk bearable.

The main difficulty to my mind is that an announcement at the time of the Public Expenditure White Paper in January could lead to higher spending in the two years before the community charge comes into operation: local politicians and officials will not take the threat of the community charge as seriously as its reality. I suggest that the announcement should be made in January 1989 rather than in January 1988. The Treasury cannot complain that this would allow too short a time for consultation since their original proposal was for announcement in January 1988 with the change coming into effect in April 1989. No discussions with other colleagues should be held until Autumn next year, to reduce the risk of leaks.

Any suggestion that the change will be welcomed by local authorities because it would signal less interference by central Government should be treated with suspicion: less interference too often tends to mean higher expenditure in cases like these.

D. R. Norgrove
9 November 1987

PMMAKF

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0538
From The Secretary of State for Wales

The Rt Hon Peter Walker MBE MP

3 November 1987

LOCAL GOVERNMENT BILL (COMPETITION)

I refer to your letter of 15 October to John Major about issuing a consultation paper in England on the de minimis threshold below which work would be exempt from competition and your proposals for phasing.

I am content with the approach you propose to adopt and I intend to issue a similar consultation paper in Wales at about the same time.

I am copying this to the Prime Minister, Willie Whitelaw, John Wakeham, Kenneth Baker, John Moore, Paul Channon, Douglas Hurd, Norman Fowler, David Young, Malcolm Rifkind and to Sir Robert Armstrong.

The Rt Hon Nicholas Ridley MP
Secretary of State for the Environment

Local Gov't: Rels PT33.

003/2986

CBG

CHIEF SECRETARY TO THE TREASURY

CDP
3/XI

Treasury Chambers, Parliament Street, SW1P 3AG

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

3 November 1987

Dear Nick,

GRANTS FROM THE EUROPEAN COMMUNITY IN RESPECT OF CURRENT EXPENDITURE BY LOCAL AUTHORITIES

FIG WITH BUP

Thank you for your letter of ~~7~~ September in reply to mine of 10 August. I am also grateful for Peter Walker's letter of 27 August, Norman Fowler's of 11 September, Kenneth Clarke's of 17 September, Tom King's of 18 September and Ian Lang's of 30 September.

I remain of the view that neither the scale nor the character of receipts under Article 15 of the ERDF regulation is such as to justify, in principle, their exemption from the Government's agreed policy of ensuring, as far as possible, that receipts from the Community budget do not increase domestic public expenditure.

I do, however, recognise that there may be a transitional problem in identifying the savings that are required fully to offset the additional local authority spending which the Article 15 receipts finance. Although this is far from being a unique problem as regards either EC-related or purely domestic public expenditure, I am conscious that the continuing uncertainty over our treatment of these receipts is beginning to create difficulties for ERDF applications involving quite large amounts of money.

LOCAL GOVT : Relations PT33

In these circumstances, I am prepared to make a suggestion with the aim of facilitating early resolution of the issue without undermining our policy on Community receipts. The suggestion is that we disregard Article 15 receipts until the end of 1988-89 - subject to a cumulative upper limit of £5 million - on the understanding that the normal additionality rules would apply in subsequent years. That is to say, Departments would be expected to identify savings within their own programmes to offset these receipts unless they could convince the Treasury and colleagues collectively to the contrary in the annual survey procedure.

I very much hope that you and other colleagues whose programmes are affected by Article 15 receipts will agree to proceed on this basis. Our officials could discuss the detailed arrangements.

I am copying this letter to the Prime Minister, David Young, Kenneth Clarke, Peter Walker, Malcolm Rifkind, Tom King, Norman Fowler, Geoffrey Howe and to Sir Robert Armstrong.

Yours Ever,

John

JOHN MAJOR

003/4206

CONFIDENTIAL

CCBG

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

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

NBPM.

Dear Nick,

2 November 1987

LOCAL AUTHORITY CAPITAL SPENDING topens

Your letter of 28 October sets out proposals for issuing extra allocations this year to help offset the emerging underspend on DoE/LA1.

You suggest £75 million allocations be distributed pro rata to net provision and that the storm costs be considered separately. I understand this approach is acceptable to Kenneth Baker whose letter I have seen, Paul Channon and John Moore. On that basis, I am prepared to accept your proposals.

I am copying this letter to the Prime Minister, members of E(LA) and Sir Robert Armstrong.

Yours Ever,

John

JOHN MAJOR

P 02900

PRIME MINISTER

A "STOP" POWER FOR THE DISTRICT AUDITOR

[Letters of 6 and 29 October from Mr Ridley and of 12 October from the Chief Secretary]

DECISIONS

The Environment Secretary wants the Government to table a Government amendment to the Local Government Bill which would give him a new power to impose prudential requirements on local authorities. The Audit Commission is currently trying to develop such a system in the form of prudential ratios which would limit an authority's borrowing in the light, presumably, of its revenues and assets (although the details of what they envisage seem unclear). Mr Ridley hopes that local authorities will accept such a regime voluntarily, but he wants a power in reserve to impose it if necessary.

BACKGROUND

2. Ministers agreed in correspondence in July that the Local Government Bill should include new provisions to give the auditor pre-emptive powers to stop unlawful spending by local authorities, in addition to the auditor's existing power to act after the event. But Mr Ridley's colleagues reserved judgement on a second proposal to impose a new prudential regime on local authorities: the underlying concept at that time was to require local authorities to balance the interests of present and future rate or community charge payers when they undertook borrowing or other financial liabilities. Doubts were expressed about whether such a system would be workable in practical or legal terms.

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MAIN ISSUES

3. Mr Ridley's new proposal has much the same aim, but is entirely different in form. It appears to avoid the difficulties of interpretation and enforcement associated with his earlier proposal, but it is far from precise. All that the note attached to his letter of 6 October says on the actual technical substance is that the limits of financial prudence defined under the regulations would be likely to be in terms of ratios between financial commitments and the means to meet them; but that the proposed power would not prevent other possibilities. This seems sensible so far as it goes, but it appears that prudential ratios for local authorities are still only a broad concept, and much work is required to make them a reality.

4. The main issue therefore is whether it is wise to take the power which Mr Ridley proposes in the Local Government Bill in view of the work which remains to be done. You may wish to explore where the Audit Commission have got to. Mr Ridley's latest letter of 29 October mentions that the Commission is setting up a new joint working party with the local authorities. You might find it helpful to know how long the work of this working party is likely to take, and what are its chances of success.

5. Mr Ridley is likely to argue that it is worth taking a power now to show that the Government means business. He points out that legislation might in itself persuade authorities to agree to a voluntary regime. On the other hand the power would presumably be broad and unspecific which might raise suspicions in Parliament and elsewhere about the Government's intentions; and the power might turn out not to do what was wanted. The choice appears to be between taking the power as Mr Ridley proposes, or deferring any legislation in the hope that local authorities will accept prudential ratios voluntarily or that, if they do not, a suitable slot could be found in a future legislative programme to deal

with the problem in an authoritative manner. You will want to decide whether Mr Ridley's arguments are strong enough to justify legislation in the present Session.

VIEWS OF OTHER MINISTERS

6. The Chief Secretary, Treasury is likely to suggest that the benefits of Mr Ridley's proposal depend entirely on the success of the Audit Commission in developing workable prudential ratios. He will probably press the Environment Secretary to do everything he can to push this work forward quickly. He may nevertheless agree that it would be helpful to take a reserve power at the earliest opportunity. The Secretary of State for Wales will be concerned that any powers can be operated separately for Wales if necessary.

HANDLING

7. You will want to ask the Environment Secretary to speak to his proposal. The Chief Secretary, Treasury and the Secretary of State for Wales will want to comment. You may also want to ask the Business Managers whether the amendments which Mr Ridley would have to introduce would measurably affect the Parliamentary handling of the Local Government Bill.

RTJW.

R T J WILSON
Cabinet Office
30 October 1987

CONFIDENTIAL

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

The Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

29 October 1987

Dear Chief Secretary,

A "STOP" POWER FOR THE DISTRICT AUDITOR

My letter of 12 October proposed a reserve power to reinforce the Audit Commission initiative for self-regulation on local authority financial prudence. This is linked to the main (Part I) "Stop" power proposals, which it is already agreed should be included in the Local Government Bill.

Your reply of 12 October acknowledged the time pressures, noted the discussions between officials that have now taken place, and asked for a discussion with colleagues. We are meeting in E(LF) next Tuesday, and taking this item on the basis of our exchange of letters. Our officials have exchanged further details.

The Audit Commission have now approached the local authority associations for a joint working party on their self-regulatory proposals. It is important that I back this initiative with consultation on my "Stop" power and reserve power proposals. I hope that you and other colleagues will agree next Tuesday that I may press ahead with public consultation, and with drafting clauses for the reserve power. At best, there will only be five weeks available if we are to be ready for report stage of the Local Government Bill in mid-December.

I am copying this letter to the Prime Minister, the Lord President, other members of E(LF) and to Sir Robert Armstrong.

Yours sincerely,

NICHOLAS RIDLEY

(Approved in draft by the Secretary of State and signed in his absence.)

This is 100% recycled paper

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c/BG

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
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01-212 3434

My ref:

Your ref:

The Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

28 October 1987

NBPM

Dear John

LOCAL AUTHORITY CAPITAL SPENDING, 1987/88

Thank you for your letter of 23 October. I am disappointed that you feel able to offer only £75m additional allocations for all services, when the underspend on the cash limit is expected to be some ten times as large. My proposals were framed to meet just the criteria you suggest: to be worthwhile in themselves, to lead to cost-effective expenditure in the current financial year and to avoid pressure on spending in later years.

I am conscious, however, that time is passing, and that to secure cost-effective spending we must make an announcement very soon. For the sake of an agreement, I hope that you will be prepared to increase your suggestion of £75m for all services by the amount of extra allocations that will be required to fulfil the Government's undertaking in respect of damage caused by the recent storm. Clearly, we should not issue allocations except where the expenditure is (a) unavoidable (b) of a capital nature and (c) not capable of being met from other sources. Much of the authorities' immediate expenditure on the storm will be revenue rather than capital expenditure and will receive support under the "Bellwin" scheme; and to the extent that they have prudently insured their property, the insurance payments will meet the cost without any need for additional capital allocations and borrowing. However, we all accept that some additional allocations will be required, and we cannot afford to delay allocation of the £75m whilst we wait, perhaps many weeks, before establishing the precise size of the storm damage requirement.

On the distribution of the £75m allocations between services, I would reluctantly be prepared to accept a basis of allocation pro rata to net provision, although this disadvantages the services for which I am responsible by comparison with others. I would propose to use the share which would otherwise fall to the Other Services block for the benefit of Housing, giving it a total of £44.7m, as compared with £18.9m for Transport, £9.4m for Education and £2.0m for Personal Social Services.

I hope that, for the sake of an early agreement, you and other colleagues concerned will be able to agree to this proposal. If so, I shall make an early announcement, simultaneously with the release to local authorities of the forecast for the year's underspending based on expenditure in the first quarter. My officials will consult yours about the precise details.

100% RECYCLED PAPER

local Govt Relations Pr 33

CONFIDENTIAL

Separately, your letter crossed with mine of 21 October on end-year flexibility. I shall await a further reply from you on this issue.

I am copying this letter as before to the Prime Minister, Members of E(LA) and Sir Robert Armstrong.

NICHOLAS RIDLEY

CONFIDENTIAL

cc SG

ELIZABETH HOUSE
YORK ROAD
LONDON SE1 7PH
01-934 9000

The Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

NBPM.

27 October 1987

Dear John,

DOE/LA1 CASH LIMIT: END YEAR FLEXIBILITY

Nicholas Ridley's letter to you of 21 October proposed that the end-year flexibility (EYF) arrangement which is part and parcel of the local authority capital controls should operate in respect of the expected underspend of the 1987-88 cash limit. Your letter of 23 October appeared to cast doubt on the appropriateness of this.

I strongly support the arguments Nicholas puts forward for implementing EYF - although I cannot agree with his suggestion for distributing the extra allocations. We could not defend the abandonment of EYF when we have every reason to suppose that the cash limit is heading for a large underspend, having confirmed the arrangements as recently as March this year with specific reference to 1987-88.

As to the distribution of allocations between services if, as I hope, you agree to retain EYF, it is essential that education should benefit. There is no defensible basis for omitting education from the prospective additional allocations, since as you are aware the attribution of provision between services is out of line with the realities. What is more, education receipts have been coming in at a substantially higher level than was forecast, with the result that the "overspend" on education which is an automatic consequence of the maldistribution of provision is in fact forecast to be lower in 1987-88 than the figure we

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anticipated for the current year and which we took into account in our PES discussions. If there are to be additional allocations, the basis for their distribution needs to be agreed among us.

I am copying this letter to the Prime Minister, Willie Whitelaw and members of E(LA) and to Sir Robert Armstrong.

Yours ever,

Norman

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From The Secretary of State for Wales

The Rt Hon Peter Walker MBE MP

CONFIDENTIAL

26 October 1987

WITHDRAWN

E(LF)(87)(41): FUTURE OF LOCAL AUTHORITY CAPITAL CONTROLS

I thought it might be helpful if I set out my comments on this paper in writing in advance of Tuesday's meeting.

I am somewhat unhappy that we are discussing the capital control system in isolation from new proposals on housing finance when, after all, housing and in particular housing receipts is the most significant single component in the local government capital package. Certainly by the time any consultation paper is issued to local government I think we need to be in a position to describe at least in general terms the linkages between the proposed capital control system and changes to housing finance.

That apart I am content for Nicholas Ridley to work up these proposals and to draft a consultation paper. Clearly though there are a number of points which will need to be explored more fully during that process; I see the following as amongst the more important:

Papar para 4; I am not sure that local authorities' judgements on community charge levels will necessarily lead to the level of capital expenditure which we want. I would prefer a more direct control on revenue contributions to capital expenditure;

Paper para 11; I would prefer to continue to issue approvals on the basis of service blocks ie "housing" and "non housing" in the case of Wales as well as being able to link specific elements with specific projects. I am therefore happier with the description at para 5 of the annex than with the rather ambivalent phrasing on para 11 of the main paper;

/...

The Rt Hon Viscount Whitelaw CH MC
The Lord President of the Council
Privy Council Office
68 Whitehall
LONDON

Annex para 20; The treatment of receipts will have to be looked at carefully. There must be some incentive to authorities to raise receipts, there may be a case for taking only a proportion of their receipts capacity into account when making borrowing approvals, or for allowing a 100% addition to their approval level. As at present I would need to have the power to set different proportions in Wales;

Annex para 25; I do not think that, politically, we can simply wipe out existing accumulated receipts which do not happen to be backed by cash. Local authorities, rightly or wrongly, would simply represent this as a seizure by central Government of their money.

Annex para 27; It seems to me that repair and maintenance should continue to be treated as capital expenditure. The 'wider consents' would need to be exercisable separately in Wales.

I am copying this letter to other members of E(LF) and to Sir Robert Armstrong.

CONFIDENTIAL

cc Bligh

PRIME MINISTER

FUTURE OF LOCAL AUTHORITY CAPITAL CONTROLS

[E(LF)(87)41]

DECISIONS

E(LF) needs to agree on a new system for controlling local authority capital expenditure in England and Wales, to take effect in 1990/91 at the same time as the introduction of the community charge. Mr Ridley wishes to initiate consultations on the new system before the end of this year, with a view to preparing a Bill for introduction in November 1988. At this first meeting you will probably want to have a "Second Reading" debate on the general nature of the new system. In particular, Mr Ridley seeks agreement to four basic proposition -

i. That the new system should operate through controls on borrowing for capital purposes rather than on capital expenditure as at present.

ii. That the new system should be designed as far as possible to prevent creative accounting by local authorities using devices such as sale and lease back schemes.

iii. That the use of capital receipts should be controlled so that authorities with receipts can undertake some additional spending, but not to the extent where it threatens the Government's ability to target resources.

iv. That the new system should include requirements about debt redemption, partly to mop up capital receipts, and partly to prevent creative accounting.

Depending on the outcome of your discussion, you will either wish to ask Mr Ridley to develop his proposals further in the form of a consultation paper, or to bring forward revised proposals.

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BACKGROUND

2. The present system of capital controls was introduced in the Local Government, Planning and Land Act 1980 and has been in force since 1981/82. It sets a limit on the capital expenditure which each authority can undertake each year. The limit comprises capital allocations issued by Government plus various additions, of which the most important is a prescribed proportion of capital receipts from sales of assets. (There is also a secondary control over borrowing for capital purposes). The system was designed to control aggregate capital expenditure net of receipts against the Government's public expenditure plans. But in practice it has failed to do this: in some years there have been large overspends against the national cash limit, while in other years there have been equally large underspends. The system has also been subject to a large volume of criticism, both from local authorities and from bodies like the Audit Commission and the National Audit Office.

3. The Government therefore instituted a review of the system in 1984 in consultation with the local authority associations. After further work within Government, two possible new systems were set out in the Green Paper "Paying for Local Government" -

i. A system based on External Borrowing Limits (EBLs) for local authorities, similar to the EFLs which apply to nationalised industries. However the Green Paper acknowledged that there were severe practical problems with a regime of this sort, and that it might not in any case be suitable for controlling local authority expenditure.

ii. A system based on control of gross capital expenditure, whether finance from borrowing, capital receipts or contributions from the revenue account. The Green Paper made it clear that this was the Government's favoured approach at that time.

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Most respondents to the Green Paper took the view that the EBL approach was unworkable, and Ministers accepted this. But there was also considerable opposition to the second option of control over gross capital expenditure.

4. Nevertheless in July 1986 Mr Ridley sought agreement from E(LA) to legislate in the 1986/87 Session for a new system based on control of gross capital expenditure. He hoped to secure the necessary legislation before 1 April 1987, so that the new system could be introduced in 1987/88. His haste was due in part to problems in setting capital allocations for 1987/88 within the constraints of the public expenditure provision and commitments made to local authorities by his predecessors. But after E(LF) discussions in both July and September 1986 the Government decided that it was neither practical nor desirable to attempt to legislate for a completely new system on this timetable. Mr Ridley therefore announced in October that the Government would not proceed with reform in the last Parliament, but would work towards introducing a new system alongside the community charge in 1990/91.

MR RIDLEY'S PROPOSALS

5. The system which Mr Ridley now recommends is a substantial departure from the earlier proposals. Its key features are -

i. The main control would be on borrowing for capital expenditure rather than on expenditure itself. One consequence is that local authorities would have the discretion to incur extra capital expenditure if they could finance it from revenue sources - but the new community charge regime would of course be a constraint on the amount of the expenditure which could be financed in this way.

ii. Authorities would be able to undertake some additional capital expenditure where they had capital receipts. The use of receipts would still have to be controlled, but the rules would be different from those of the present system.

Mr Ridley's proposal is that authorities should be able to spend 50 per cent of receipts, either in the year they were received or in any subsequent year.

iii. Common creative accounting devices like sale and lease back would be treated as capital borrowing under the new system, which should remove their attraction for local authorities. Similarly leasing transactions and capital expenditure by local authority companies would fall within the controls.

iv. Local authorities would be required to make a standard level of provision for debt redemption. The aim would be to prevent the use of debt rescheduling as a creative accounting device on the revenue side.

6. The treatment of housing capital expenditure is one key issue which is not properly addressed in the paper. Mr Ridley earlier proposed to establish Unified Housing Accounts (UHAs) which would subsume housing capital spending, and take it out of the capital controls system. I understand that he is now considering substantially different proposals, although he still envisages that housing capital would be outside the general control system. Nevertheless, all the figures for receipts in his paper appear to include housing. This is a crucial point because the high level of housing capital receipts (arising from the right to buy) has played a large part in the problems of the present system. You may want to ask him to clarify the position on housing, and to bring forward proposals in that area as soon as possible. It is difficult to see how he could possibly issue a consultation paper on capital controls without also making proposals about housing capital.

MAIN ISSUES

7. You will want to consider the implications of Mr Ridley's proposals in a number of key areas -

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i. For the control of economic aggregates such as public expenditure and the Public Sector Borrowing Requirement (PSBR).

ii. For the targetting of resources.

iii. For their likely reception by your supporters in local government.

Control of Public Expenditure and the PSBR

8. There are no less than three economic aggregates which the Government might want to influence through the capital controls system -

i. The Local Authority Borrowing Requirement (LABR) which is a component of the PSBR.

ii. Net capital expenditure by local authorities, which is what scores in the Government's public expenditure (PE) plans.

iii. Gross capital expenditure by local authorities, which is what scores for the national accounts.

The present capital control system was designed to deliver net capital expenditure in line with PE plans, but has generally failed to do so. The Green Paper proposals aimed principally at the control of gross capital expenditure. In contrast Mr Ridley's new proposals are designed primarily to control the LABR. I understand that Treasury Ministers will be briefed to support Mr Ridley's proposals on this score - the Treasury take the view that the LABR is the most important of the three aggregates to control, given its influence on the financial markets. Your reaction will depend in part on whether you share this view.

CONFIDENTIAL

9. Even with the system outlined by Mr Ridley, there will be very little chance of delivering a particular figure for the LABR in a particular year. That is effectively ruled out by the level of local authority capital receipts and the freedom which authorities will retain over their use. Nevertheless the treatment of receipts proposed by Mr Ridley has some substantial advantages over that in the present system -

i. The restriction on the proportion of capital receipts which local authorities can use to justify additional spending will apply both to the year in which the receipt accrues and to any future year. This will correct the flaw in the present system (the "cascade") which limits authorities to using 20 or 30 per cent of a receipt in the year it occurs, but allows them to use the whole of the remainder in future years.

ii. Capital receipts which are not backed by cash - eg because the money has been used to redeem debt or for another purpose - will not be available to justify additional spending.

iii. These two features will result in a dramatic fall in the amount of spending power resulting from past capital receipts. Under the present system there is an overhang of some £8 billion of receipts which authorities could use to justify additional spending. Under the new system that part which is not backed by cash - over a third of the total - will no longer be available. Furthermore authorities will be limited to additional spending equal to only 50 per cent of the remaining receipts. The overhang will therefore be reduced immediately to between £2 billion and £3 billion.

The new system will therefore result in an immediate cut in the overhang of spending power from past receipts. The overhang is likely to be further reduced in subsequent years as the new system obliges authorities to use up the spending power of their receipts. The proposed system therefore promises improved control of the LABR

in later years. But you will need to weigh these advantages against the implications for the reception of the new system by local authorities (see below).

Targetting of Resources

10. The system proposed by Mr Ridley also offers better targetting of the available resources on local authorities with real needs. Under the present system Ministers cannot take account of the availability of capital receipts to individual authorities when they make capital allocations. Under the new system they will be able to take account of capital receipts in setting borrowing approvals. They could for example give higher borrowing allocations to inner city authorities who have comparatively small receipts, and smaller allocations to rural authorities which have large receipts, eg from council housing. But such targetting could also have disadvantages. First, it may lead to opposition among those authorities who are effectively required to use up their spending power from past and present receipts before they get borrowing allocations. Second, it further reduces the incentive to generate capital receipts: although an authority will in theory be allowed to use 50 per cent of receipts to justify additional spending, if it knows that the additional spending power will be taken into account in its borrowing allocation for the next year, the incentive will effectively be removed. To counter this, Mr Ridley may propose that only half of the additional spending power accruing from new receipts should be taken into account in borrowing limits. But of course this will blunt the extent to which resources can be targetted. You may wish to probe Mr Ridley about the trade off between targetting of resources and incentives to generate receipts.

Likely Reaction of Local Authorities

11. Mr Ridley's proposed system has some substantial advantages for authorities -

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i. It is based on control of borrowing for capital purposes, which is the system which the local authority associations have argued for in the past.

ii. It allows authorities additional spending power to the extent that they can afford to finance it out of revenue spending. This is an important new flexibility, although it will be restricted by the constraints of the community charge regime.

iii. It appears to allow a more generous use of capital receipts, up to 50 per cent compared to the limits of 20 and 30 per cent which apply at present.

But against this there are also substantial disadvantages for authorities -

iv. Much of the spending power resulting from the present overhang of receipts will be extinguished as noted above. New receipts will generate no more than the 50 per cent spending power, removing the cascade effect which applies to present receipts in subsequent years.

v. Taking account of the spending power associated with receipts when making borrowing allocations will oblige many authorities to use up their receipts. Those who see allocations transferred to authorities without receipts, either because they have been unable or unwilling to generate them, may resent the fact. (However it should be noted that there is no question of transferring the revenue benefits of receipts - authorities which have generated receipts will benefit either from the interest they generate or from avoiding interest on new borrowing).

vi. The proposals on leasing, capital spending by local authority companies and debt redemption will remove a lot of flexibility they currently enjoy over capital financing.

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You may want to ask Mr Ridley how he thinks that different groups of local authorities will react to his proposals.

Overall Assessment

12. Overall Mr Ridley's proposals do look like a substantial improvement on the present system and even on the package considered by E(LA) last year. They offer a better chance of controlling the LABR, particularly once the overhang of capital receipts is reduced. They will provide better targetting of the available resources on authorities with real need to undertake borrowing for capital expenditure. They will clamp down on a number of common creative accounting devises. And they do appear to strike a reasonable balance between the Government's need to control the aggregates and the desire of the local authorities for flexibility, particularly over the use of capital receipts. But you will want to form your own view about the balance of advantages and disadvantages, taking into account in particular the political implications.

VIEWS OF OTHER MINISTERS

13. I understand that the Chancellor of the Exchequer is likely to support Mr Ridley's proposals, both from the point of view of controlling economic aggregates (as noted above), and in terms of their impact on local authorities. Service Ministers are also likely to be in favour of Mr Ridley's proposals, subject to concern about a number of matters of detail which will need to be dealt with in further work. In particular, the Education Secretary and other Ministers will be keen to retain individual allocations of some sort for their own services. The Home Secretary will also need to consider how he wishes to deal with capital spending on the police, magistrates and probation services, which are handled outside the general capital controls system at present. The Secretary of State for Wales will not be at the meeting, but is expected to write beforehand supporting the general thrust of Mr

Ridley's proposals, but expressing concern about the absence of proposals on the control of housing capital expenditure.

HANDLING

14. You will want to ask the Environment Secretary to introduce his paper. The Chancellor of the Exchequer will want to comment in general terms. Service Ministers will wish to speak about the implications for their responsibilities.

R T J WILSON
Cabinet Office

23 October 1987

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010

CONFIDENTIAL

CC/BG

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

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

23 October 1987

Dear Nick,

NJM.

LOCAL AUTHORITY CAPITAL SPENDING 1987-88

WILL REQUEST IF REQUIRED

You wrote to me on 6 October proposing that housing allocations be increased in response to the emerging underspend on local authority capital spending in England. Paul Channon's and Kenneth Baker's letters of 8 October and 16 October also bid for further allocations for their programmes.

Gross local authority capital spending in England is still expected to be £370 million higher this year than allowed for in the 1987 Public Expenditure White Paper. The emerging underspend is entirely due to receipts being more than £1 billion higher than forecast. A substantial proportion of those receipts reflects sale and leaseback deals and a switch from public to private financing of council house sales.

Experience of previous attempts to stimulate spending in-year has been very unsatisfactory. The last time we issued extra allocations to reduce a prospective underspend was in 1983-84. In the event an overspend of £415 million emerged. I do not want to risk repeating that episode. Since 1983-84 there has been further overspending in 1984-85 (£1,072 million), 1985-86 (£996 million) and 1986-87 (£18 million). It proved impossible to take offsetting in-year action to avert these overspends and no cash limit penalties were subsequently imposed.

In view of this history and the nature of the receipts causing the underspend you will appreciate that I am reluctant to take steps that would increase gross spending even further. Issuing substantial further allocations this year would be harmful for two reasons. First, there is a danger that the allocations would to a significant degree be used instead of spending power from receipts, so increasing the cascade of accumulated receipts carried forward into future years. This could lead to renewed overspending next year. Secondly, it would be interpreted as a signal that we were relaxing our control of local authority capital spending.

In reacting to an emerging underspend this year which is due to higher receipts we need to take account of the fact that receipts not spent this year are not lost, but generate spending power in later years. Although, for any given level of provision in 1988-89, higher accumulated receipts are offset by lower allocations, the outcome of the Survey has been that, overall, allocations will be higher than in 1987-88, thereby in effect allowing higher spending power of accumulated receipts to be reflected in full in gross provision. In these circumstances, there would be a double benefit if higher receipts this year produced more gross spending this year and next.

Thus I do not accept that there is any presumption that a shortfall resulting from higher receipts should be offset. Nevertheless, I am prepared to look at proposals on their merits provided we can be sure that the money will be spent this year and provided it will reduce pressure for spending in later years. On this basis, I am prepared to consider a package of up to £75 million for all the services combined. If you and colleagues agree I suggest we ask officials to recommend how such a package might be constructed.

If immediate capital expenditure is needed to make good the damage caused by last week's storm, that could be one of the uses to which the £75 million is put.

I could not however go beyond that; and in particular, bearing in mind the absence of cash limit penalties for recent overspends, I do not believe it would be appropriate to allow the prospective underspend to be carried into future years through end-year flexibility.

I am copying this letter to the Prime Minister, members of E(LA) and Sir Robert Armstrong.

Yours Ever, John

JOHN MAJOR

CONFIDENTIAL

CCBG.

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

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

23 OCT 1987

NBPM

Dear Nicholas,

PTAs UNDER THE NEW LOCAL GOVERNMENT REGIME

Thank you for your letter of 30 September attaching a note by officials on the treatment of Passenger Transport Authorities under the new Local Government Finance regime.

I agree that the case for changing the status of PTAs from precepting to billing authorities hinges on accountability. My own view is that the need for metropolitan district councils to consider the contribution to PTA expenditure as an integral part of their budgets must lead them to think more responsibly about whether the decisions being made by PTAs are the right ones for their electorates. That can only improve the accountability which the district councillors who form the PTA will bear to their community chargepayers.

The difference as I see it between the PTAs and the police and fire joint boards is that, since bus deregulation, we see secession by district councils as a real option which we would like to encourage. If Wirral for example believes that bus service provision for their residents is more expensive than can reasonably be afforded by community chargepayers, then the district ought to be allowed to make its own decisions.

I am not claiming that the change would resolve the intractable public transport GRE problems. But they would no longer have such a high profile if they were incorporated in the other services GRE to produce the Met districts total spending needs. Public transport spending only constitutes about 5% of total local authority spending in Met areas so they are not going to be very significant for districts even if they have to remain as a separate GRE. But when that spending is the sole responsibility of a separate authority

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accountable for its spending in relation to GRE, the difficulties are brought into much greater relief, as has been only too clear in the past two years of precept control. It would therefore put at greater risk the accountability we are seeking.

I am anxious to promote the secession option with all metropolitan districts, and a change from precepting to billing would be a suitable opportunity. As the officials' note indicates, secession is possible under existing legislation, though districts have shown little interest so far. It is possible under the legislation to secede in respect of bus services but not rail services, so I do not see the present role of the PTAs in supporting local rail services as an insuperable difficulty. An Order enabling partial secession could be much simpler if it did not have to include complex provisions for differential precepting.

Grant arrangements for dealing with secession would also be simplified. If PTAs remain precepting authorities, a seceding district council would have to be allotted a separate GRE for the public transport functions it took over. These would probably not include Section 20 support to BR, and would probably be limited to bus services. To accommodate secession we would therefore need to have separate GRE formulae in the new block grant system for bus services, Section 20 and other services' support. This would run completely counter to our aim of simplifying GREs. The change I am suggesting would avoid this difficulty as all the public transport element of the GREs, however simplified, would go to the districts whether or not they seceded.

I agree with you that my arguments lead to the question whether there is a real need for the PTAs in the longer term. Indeed it may well be that the effect of my proposals will be that in some areas PTAs will 'wither away'. But I believe it would be premature to announce any intention of wholesale abolition as yet. Legislation would be very complex as it would have to deal with transfer of powers and assets from PTEs as well as PTAs. It would also have to deal with the bus companies owned by PTAs (I am currently giving further thought to their future), and with tunnels, ferries and the Tyne & Wear Metro as well as BR services.

Abolition would also be very controversial, particularly because it could be presented by our opponents as a means of breaking up country-wide concessionary fare schemes outside London. It would also be thought that we were seeking to diminish the prospects of new light rail schemes currently under consideration. I do not therefore agree that abolition is a practicable alternative to a billing mechanism within the new local government finance regime. It would be much easier to explain, particularly to our supporters, that we were offering districts freedom of choice in deciding whether or not to assume responsibility for their own transport decisions.

I hope that in the light of these arguments you can now agree that the Local Government Finance Bill should include provisions to change the financial relationship between PTAs and metropolitan districts from precepting to billing.

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

Yours,

Paul

PAUL CHANNON

LOCAL GOVT. Relations PT53

PS/ PRIME MINISTER

CCB9

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
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Telephone (Direct dialling) 01-215)
GTN 215) 4417
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From the Parliamentary Under Secretary of State
for Corporate and Consumer Affairs

The Hon Francis Maude MP

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

21 October 1987

NBPM

Dear Nicholas,

LOCAL GOVERNMENT BILL (COMPETITION)

You copied to David Young, who is abroad at present, your letter of 15 October to John Major.

at flap

I am content with the proposals in your draft consultative document on implementation of the Bill, and with your intention to issue it to coincide with the resumption of the Committee on the Bill. It is clearly desirable to set as low a de minimis threshold as is realistic, to ensure that the maximum amount of work is made subject to competition. The proposals for phasing in the competition requirements should ensure that neither authorities nor contractors are overburdened, whilst preserving even-handedness.

Your proposals would entail implementing the legislation on the same timetable for the inner cities as for other authorities. This seems right, for the reasons you give, on grounds of even-handedness, and because one could not be sure that any attempt to favour the inner cities would necessarily achieve the desired result. However, this does anticipate collective discussion of the Urban Policy Review, and you will no doubt be taking account of any further points which emerge from this, as well as from the reactions to the consultative document on this point.

J05BZZ

I am copying this letter to the Prime Minister, Willie Whitelaw, John Wakeham, Kenneth Baker, John Moore, Paul Channon, Douglas Hurd, Norman Fowler, John Major, Malcolm Rifkind and Peter Walker, and to Sir Robert Armstrong.

FRANCIS MAUDE

Local Govt: Rets! PT33

J05BZZ

999-49

MINISTER FOR HOME AFFAIRS AND THE ENVIRONMENT

ce/BG

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

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

21 October 1987

Dear Nicholas,

NBPM.

LOCAL GOVERNMENT BILL (COMPETITION)

I refer to your letter of 15 October to John Major enclosing a draft consultation paper on implementation in England which you hope to issue before Committee resumes on 22 October. I am replying on behalf of Malcolm Rifkind, who is currently abroad.

We support your proposals for implementing the competition provisions in the Bill and have in mind a separate consultation paper for Scotland setting out proposals for phasing-in competition broadly along the lines proposed for the English authorities. We also plan to propose a "de minimis" threshold of £100,000.

A copy of this letter goes to the Prime Minister, Willie Whitelaw, John Wakeham, Kenneth Baker, John Moore, Paul Channon, Douglas Hurd, Norman Fowler, David Young and Peter Walker and to Sir Robert Armstrong.

yours
James

JAMES DOUGLAS-HAMILTON

LOCKOUT

RELATIONS

PT 33

NBPM

PRIME MINISTER 19 October 1987

LOCAL GOVERNMENT BILL (COMPETITION)

Nicholas Ridley proposes to issue a consultation paper on the implementation of the competition provision in the current Local Government Bill. This would set out a timetable for local authorities to seek competitive tenders for the six services initially to be covered.

This legislation will have a major impact on local authority costs. For example, the Chief Executive of Kirklees Council told me that the going rate for cleaners in the private sector in West Yorkshire is about £1.60 to £1.70 an hour compared with around £2.50 for local authority staff.

Method of Implementation

Local authorities would be divided into six groups, with a roughly comparable geographical spread. The first group would have to seek tenders for refuse collection and street cleansing within six months, in the next six months for building cleaning and so on until within three years all services covered would have to be contracted out. The other groups would have to follow the same timetable but taking the services in a different order.

Effect of Proposal

Wandsworth's experience suggests that contracting out works best with contracts containing detailed and specific performance criteria and proper monitoring. This approach takes time to organise properly.

The proposed procedure would ensure that key local authority staff (eg finance departments) could give full attention to each service and improve procedures as the timetable progresses. It would also ensure that contractors in any one industry would only need to deal with authorities in one group at a time. We agree that it is sensible to give contractors and local authorities advance notice of this timetable.

Conclusion

We support Mr Ridley's proposal to issue a consultation document on implementing the contracting out procedures in the current Local Government Bill.

Peter Stredder.

PETER STREDDER

cc BG

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

The Rt Hon The Viscount Whitelaw CH MC
Lord President of the Council
Privy Council Office
Whitehall
LONDON
SW1

19 October 1987

N BRN.

Dear Willie

As is customary, I am attaching the latest lists of central government initiatives, having financial and manpower implications for local government, which has been notified to my Department during the last six months. The first list contains details of proposals which are likely to result in increases in demands on local government and the second list identifies measures which are expected to lead to some reduction.

This first list shows a slight decrease over that for the preceding period (26 compared with 28). However some major policy initiatives, often with potentially substantial implications for local government, are now coming on stream. It is important that the local government implications of these major new items should be considered from the outset, at the formative stage when these new initiatives are being planned. I have therefore asked my officials to contact their colleagues in Departments sponsoring some major items of legislation to confirm that local government resource costs are considered from the outset, that their totality of these is assessed and that acceptable consultations are arranged with the local authority associations.

I am a little dissappointed that we have logged only 2 proposals leading to savings for local government, compared with 4 and 8 in the two preceding periods. I hope that colleagues will carefully investigate the scope for reducing burdens on local authorities and hence on local taxpayers particularly where their new initiatives are likely to impose additional demands.

The new burdens procedure continues to be a useful means of monitoring and where appropriate influencing, the impact of new policy initiatives on local government. I propose to continue with the procedure while placing particular emphasis on some of the major new initiatives with implications for local authorities. My officials appreciate the continued co-operation and help which

This is 100% recycled paper

they have received from their colleagues in other Government Departments and I am confident that this co-operation - which has helped produce a system which is effective without being unnecessarily irritating - will continue.

I am copying this to the Prime Minister, members of E(LA) and Sir Robert Armstrong.

Yours ever

Nicholas

NICHOLAS RIDLEY

A

NEW INITIATIVES AFFECTING LOCAL GOVERNMENT - 13 MARCH - 12 SEPTEMBER 1987 :

POSSIBLE EXPENDITURE AND MANPOWER IMPLICATIONS

A. POTENTIAL INCREASES

	PROPOSAL	ORIGINATING DEPARTMENT	FINANCIAL & MANPOWER IMPLICATIONS	CURRENT STATUS WHERE KNOWN AND OVERALL COMMENTS
1.	Use of waste material for road fill: circular	DOE/DTp	De minimis ; longer term resource savings expected	Issued 7/8/87
2.	Control of Pollution (Anti Fouling Paints & Treatments) Regulations 1987.	DOE	De minimis	Effective from May 1987
3.	Redundant hospital sites in green belts : planning guidelines.	DOE	De minimis	Circular issue on 29/4/87
4.	Countryside Policy Review Panel report	DOE	Not yet quantified	Government response not yet establishe
5.	Draft response to Environment Committee report an Historic Buildings and Ancient Monuments	DOE	Not quantified	Recommendation affecting loca government un- likely to be adopted.
6.	Disposal of colliery spoil: assessment of alternative colliery spoil disposal options.	DOE	De minimis; longer term savings expected.	Circular issue 27/7/87
7.	Control of transfer of local authority mortgages	DOE	Not yet quantified; will only arise if an LA chooses to transfer mortgages to the private sector.	Introduced by Section 7 of the Local Government Act 1986.
8.	Requirement for consent for local authority assistance to privately - let housing.	DOE	Not yet quantified; likely to be small	Introduced retrospectively by the Local Government Bill.
9.	Circular on child abuse	DES	Expected to be de minimis	

	PROPOSAL	ORIGINATING DEPARTMENT	FINANCIAL & MANPOWER IMPLICATIONS	CURRENT STATUS WHERE KNOWN AND OVERALL COMMENTS
10.	The National Curriculum.	DES	To be quantified; consultations in progress. Additionality not accepted.	Education Bill
11.	Access to pupil records.	DES	Not yet quantified; expected to be small.	
12.	Bogus Degrees	DES	Less than £50,000 in the first year reducing to a few thousand pounds after 2 years.	
13.	Transfer of polytechnics and colleges from local authority control.	DES	Reduction in local authority expenditure provision and AEG; to be quantified but about £800M	Education Bill
14.	Grant maintained schools	DES	Reduction in local authority expenditure provision and AEG; extent dependent on numbers of schools gaining GM status. Consultations in progress.	Education Bill
15.	Opting out of ILEA	DES	Financially neutral; consultations in progress.	Education Bill
16.	Financial delegation to schools	DES	To be quantified; consultations and consultants' study in progress.	Education Bill
17.	Open enrolment	DES	To be quantified; consultations in progress.	Education Bill
18.	Financial delegation, reform of governing bodies and new legal basis for NAFE.	DES	To be quantified; consultations in progress.	Education Bill
19.	Police capital buildings: additional form on annual circular.	HO	De minimis	

	PROPOSAL	ORIGINATING DEPARTMENT	FINANCIAL & MANPOWER IMPLICATIONS	CURRENT STATUS WHERE KNOWN AND OVERALL COMMENTS
20.	Protection of Animals (Amendment) Bill	HO	De minimis	Private Member's Bill.
21.	Review of the effectiveness of parking enforcement.	HO	Not yet quantified	
22.	Visual standards for the Fire Service : new ophthalmological examinations	HO	£40,000-£60,000; long-term savings of £2M p.a. anticipated.	
23.	Stott report on level crossing safety.	DTP	Not yet quantified	LAAs consulted
24.	Safety standards of small boats ; new enforcement role for TSOs	DTP	Not yet quantified	New regulation proposed.
25.	"Look after your heart" campaign	DHSS	De minimis	Campaign launched on 22/4/87.
26.	1991 Census : questionnaire to LAs	DHSS/OPCS	Expected to be de minimis.	

B. DECREASES

	PROPOSAL	ORIGINATING DEPARTMENT	FINANCIAL & MANPOWER IMPLICATIONS	CURRENT STATUS WHERE KNOWN AND AND OVERALL COMMENTS
1.	Use Classes Order and accompanying circular.	DOE	Modest reduction in administrative costs and manpower requirements.	Effective from 1/6/87.
2.	Development involving agricultural land.	DOE	Minor savings as need to consult MAFF is reduced.	Circular issued on 8/5/87. Revised consultation requirement to be in new GDO early in 1988.

ps2/44R

CONFIDENTIAL

cc BG
cc BL MP

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

PRIME MINISTER

A NEW PLANNING TOTAL

As we agreed, I have put to Nick Ridley the proposals for modifying the public expenditure planning total so as to distinguish between the central government's grants to local authorities and the expenditure they finance themselves. He welcomes the approach as being both consistent with and a reinforcement of the changes we are making to local government finance. I enclose a copy of our correspondence.

He does, however, urge that the change should be made in 1990 rather than 1989. This would mean that it coincided with the introduction of the community charge in England and Wales. If changes are also made to the regime for controlling local authority capital spending it would be possible to take account of this in the new planning total from the start rather than having to make a change in the second year. Having reflected further on this, I accept the force of his arguments. I propose, therefore, that we indicate our intentions publicly in next year's debate on the Public Expenditure White Paper, produce a paper for the Treasury and Civil Service Committee in the autumn, and that the 1989 Survey and RSG negotiations be the first on the new basis.

I would now like to put the proposals to colleagues and, provided there is no unexpected difficulty, set in hand work by officials. I should be grateful to know whether you are content that I should do so.

I am copying this minute to Nick Ridley.

N.L.

16 October 1987

CONFIDENTIAL

SECRETARY OF STATE FOR THE ENVIRONMENT

CH/EXCHEQUER

REC.	06 OCT 1987
ACTION	MR TURNBULL
COPIES TO	CST MR PETER BUTLER MR ANSON MR HUNTIN MRS R. BUTLER MR GIEVE MR PRATT MR POTTER MR FELLGETT MR PERFECT MR GILWHITE MR TYRIE

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref: ~~BF~~ H/10

Your ref:

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
SW1P 3AG

2 October 1987

Dear Nigel

A NEW PLANNING TOTAL FOR PUBLIC EXPENDITURE

Thank you for your letter of 21 September proposing a revised structure for the public expenditure planning total.

I very much welcome the approach you propose and agree that we should take the opportunity offered by the introduction of the new local government finance system to make a clear distinction in our planning between what is centrally and what is locally determined expenditure. Local government should welcome the setting of grant levels 3 years ahead and this should help us presentationally with the transitional arrangements. However, we will not find it an easy task to balance the need to give appropriate signals about restraint and to set realistic totals which we do not have to change significantly each year. In the new system we will be breaking the direct link between spending and grant, but will nevertheless have to bear in mind the consequences for local taxation of the grant totals we fix.

On timing, whilst I agree that the present system is unsatisfactory, I am sure the logical time to make a change is 1990. This would co-incide with the introduction of the community charge and the new capital control system. Until 1990 I am bound by the requirements of the Local Government Planning and Land Act 1980 to set Aggregate Exchequer Grant in relation to local government's relevant expenditure for the year in question. A three year plan for grant would cut across this. I would, however, favour announcing the proposed change in the 1988 White Paper.

Before then, and subject of course to colleagues' agreement in principle, our officials need to do a good deal of further work on presenting the change and on its details. I agree with you that the precise treatment of capital expenditure must await development of the new control system, but we need to agree a broad line. We also need to consider how to treat specific grants both capital, (including on loan charges), and revenue and the interaction of these with Revenue Support Grant. Finally, as a matter internal to Government, we will need to decide how to handle the local authority element of the annual public expenditure round. I suggest that our officials should meet to take these matters forward.

Yours ever

Nick

NICHOLAS RIDLEY

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CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

21 September 1987

cc Chief Secretary
Mr F E R Butler
Mr Anson
Mr Hawtin
Mr Turnbull
Mrs R Butler
Mr Grieve
Mr Pratt
Mr Potter
Mr Pellgett
Mr Perfect
Mr G C White
Mr Tyrie

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

Dear Nick

A NEW PLANNING TOTAL FOR PUBLIC EXPENDITURE

From time to time there have been suggestions that we should restructure the public expenditure planning total so that it includes the grant central government pays to local authorities and excludes the expenditure local authorities finance from their own resources, rather than as at present including all local authority spending. This suggestion was made again at the July Cabinet meeting on public expenditure, and as I indicated it is a subject to which I have been giving some thought.

The danger we have faced hitherto in making such a change is that it would inevitably be interpreted as a weakening on the Government's determination to restrain the growth of local authority spending. However, the introduction of the community charge and the national non-domestic rate provide an obvious opportunity to re-examine the present definition of the planning total and its relationship with our objectives for public spending.

... The attached paper discusses the case for making the change in that context. This would not imply any change in our underlying objective of reducing general government expenditure (which will continue to include local as well as central government spending) as a proportion of GDP. And inclusion of forward plans for grant in the planning total will help us break away from the framework in which we are always reacting to whatever level of spending local authorities decide upon.

Before seeking the Prime Minister's agreement to putting these ideas to colleagues I would welcome your reactions. In particular, we need to consider how to organise the setting of plans for grant for three years rather than one; and the treatment of local authority capital spending. The paper assumes that the latter is within the planning total because the level of local authority capital spending is set by Government, and the aggregate used is their net spending because that is how the limit is defined. If we were to adopt a different basis for controlling their capital spending (eg by acting on borrowing) we would clearly need to think how that should be handled.

On timing, the paper suggests that the change could be made either in 1989, or in 1990 to coincide with the introduction of the community charge and the national non-domestic rate. A 1990 start would allow a new basis of control of capital spending/borrowing to be incorporated. But there are also arguments for pressing ahead and introducing the change in 1989. The present system is unsatisfactory and the sooner we can get away from it the better; and of course Scotland will move to the community charge in 1989.

If we are to keep open the option of the earlier timetable we need to press ahead quickly. I would welcome your views on both the proposal itself and the timing of its introduction.

NIGEL LAWSON

CONFIDENTIAL

A NEW PLANNING TOTAL

One of the characteristics of the way the Government in this country plans its expenditure is that it includes the spending of both central and local government in its planning total. Very few other industrial countries do this. For federal states such as Germany, the US or Canada this would be inappropriate; but even in other unitary states such as France or the Netherlands, the government makes plans only for central government expenditure.

2. There are understandable reasons why the Government makes and legislates for policies which may be implemented by either central or local government. Responsibility for education, roads and law and order is shared between the two. It is helpful in planning policy to draw together all the expenditure, irrespective of the level at which it is incurred.

3. The Government also has policies for the burden of taxation, and rates and the community charge are just as much taxes as VAT. Finally, the Government has policies for the role and scope for the public sector as against the private sector and its share of national output.

4. While drawing all public sector spending together, either in aggregate or for individual departmental programmes, has a number of advantages, it also has disadvantages. Our present procedures lump together expenditure for which government has differing degrees of responsiblity and thus blur the status of the various aggregates. If the planning total is exceeded, for example, it is not immediately clear whether responsibility for this lies with central or with local government.

5. A further disadvantage is that by counting the total expenditure of local authorities in the planning total, insufficient attention is paid to the grants which central government provide to local authorities (because they are transfers between parts of the public sector they do not count in the consolidated spending of the two sectors). Yet grant is extremely important - it is a major influence on what local authorities spend and it represents money which central government has to raise in taxes.

6. The "Paying for Local Government" reforms provide both an opportunity and a justification for rethinking our system. One of the objectives is to increase local accountability, ie to make it clear to local electorates when local spending rises whose responsibility this is, so that they can draw the appropriate conclusions. The present arrangements do not do this.

7. We see advantage in restructuring our planning of public spending on the following lines:

i. There would be no change to our underlying objectives for public spending in terms of general government expenditure (ie central plus local spending) as a proportion of GDP.

ii. But within general government expenditure the planning total would become the sum of central government's own expenditure, the grants it provides to local authorities, the permitted level of local authority capital spending and the external finance of public corporations, plus a reserve.

iii. The current expenditure which local authorities finance for themselves through the rates, and in future from the community charge, would be outside the planning total but still within GGE as debt interest is now. The attached table shows how the accounts would look.

8. The new planning total would have a number of advantages:

i. It would comprise those elements for which central government is directly responsible and it would exclude that spending which local authorities decide for themselves.

ii. It would contain the grants paid to local authorities. These would have to be planned for 3 years ahead and not just one as at present. This would not only give local authorities a better basis on which to plan their finances, but would make it clearer to the local electorate who was responsible for increases in local taxation. It would also create a baseline against which next year's discussion about grant would take place. It would help stop grant being determined by previous years' overspending.

9. There is one danger in adopting such a system. It could be interpreted as a decision by central government to give up its attempt to influence locally financed spending and to cut the local authorities free. This can be avoided if the change is made in the proper context. The new Bill will:

i. increase central control over non-domestic rates;

ii. increase pressures of accountability through the community charge.

To make the change in the context of these reforms will make it clear that the Government is still concerned about local authority spending. Continuing to express our objective in the MTFS in terms of general government expenditure (ie central and local) will also make it clear that the Government is still concerned about the level of taxation and borrowing for the whole public sector.

10. The change could be introduced either in 1989 or 1990. Under the former it would be introduced in the 1988 Survey so that the 1988 Autumn Statement/1989 White Paper set out planning totals on the new basis. Announcing three-years' plans for grant in the autumn of 1988 would give local authorities a basis on which to plan for the transition to community charge from April 1990.The latter would, however, coincide with introduction of the community charge and the national non-domestic rate and would also allow the new planning total to reflect whatever is decided on control of capital spending/borrowing.

11. If, following discussions with departments, we were to go ahead we could, on either timetable, announce our intentions in the January 1988 White Paper (though this itself would still be on the old basis). We are also planning to bring out more clearly the role of the different tiers of government in our presentation of the expenditure plans in this year's Autumn Statement and 1988 White Paper. This is a worthwhile improvement in its own right but it would also provide a helpful stepping stone to a larger change on the lines above.

H M TREASURY
September 1987

CONFIDENTIAL

A NEW PLANNING TOTAL AND GGE

£ billion

	1985-86	1986-87	1987-88
Central Govt's own expenditure	99.9	106.5	110.2
Central Govt grants to local authorities	20.2	21.7	23.1
Local authority capital expenditure*	3.8	4.1	4.2
Nationalised industries' EFLs	1.7	1.0	0.7
Other public corporations	0.9	0.8	1.0
Privatisation proceeds	-2.7	-4.8	-5.0
Reserve	-	-	3.0
NEW PLANNING TOTAL	123.9	129.3	137.2
Other local authority expenditure (including debt interest)	15.6	17.3	17.7
Central Govt debt interest	13.2	13.0	13.4
Accounting adjustments	5.8	4.8	4.9
GGE	158.5	164.4	173.2

* Subject to decisions about the new form of local authority capital control.

SECRETARY OF STATE FOR THE ENVIRONMENT

NBPM

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

The Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1

15 October 1987

Dear John

LOCAL GOVERNMENT BILL (COMPETITION)

Part I of the Local Government Bill currently before Parliament provides, as you know, for compulsory competition for a range of local authority activities. Many of the operational details are left to be set out in secondary legislation.

Two of the most important ones - the speed with which competition is phased in, and the level of any "de minimis" threshold below which work would be exempt from competition - are the subject of constant queries from all interested parties. With a view to helping them to understand the Bill better, and to helping authorities prepare themselves for its implementation, I propose issuing a consultation paper setting out detailed proposals on both topics at an early date - if at all possible before Committee resumes on 22 October.

As you will see from the attached draft we propose implementation in either five or six phases at six-monthly intervals (depending on how many of the listed activities different groups of authorities are responsible for) and a de minimis level at the very low figure of £100,000-worth of expenditure per annum. This will expose the maximum amount of work to the test of the market as quickly as we believe contractors and local authorities can cope with it.

Under this scheme inner city authorities will have to implement the legislation as quickly as all other authorities. One of the recommendations of the E(UP) urban policy review was that "the phasing in of the competition requirements should favour inner cities". It is unrealistic to expect inefficient inner city authorities to be able to cope with a faster timetable than I am proposing generally. And I do not want to delay implementation elsewhere in the hope that contractors will then be more enthusiastic in bidding for contracts from inner city authorities, many of whom will be doing all they can to discourage competition.

This is 100% recycled paper

The paper covers England only. The Bill permits different regulations to be made for different countries, and both Malcolm Rifkind and Peter Walker will wish to consider whether they too wish to consult quickly. I think that would be desirable, to avoid any difficulties in Committee, but I don't think it would cause problems if their papers were to issue a short time after mine.

I do not envisage any major complaints that issuing the consultation paper now pre-empts Parliament's consideration of the Bill, because it is local authorities as much as contractors who are pressing us for early information on implementation. But to deal with this aspect the paper emphasises that the proposals are subject to that process, and I will emphasise this when I send the paper to Jack Cunningham and other Bill Committee Members.

I would be grateful for colleagues' comments on these points and on the draft itself, if possible by 20 October. I am sending copies of this letter to the Prime Minister, Willie Whitelaw, John Wakeham, Kenneth Baker, John Moore, Paul Channon, Douglas Hurd, Norman Fowler, and David Young, as well as to Malcolm Rifkind and Peter Walker, and to Sir Robert Armstrong.

NICHOLAS RIDLEY

DRAFT CONSULTATION PAPER

COMPETITION IN THE PROVISION OF LOCAL AUTHORITY SERVICES

IMPLEMENTATION AND EXEMPTIONS

INTRODUCTION

1. This consultation paper seeks views on the Government's proposals regarding the exercise in England of two of the powers which will be provided by Part I of the Local Government Bill provided it is enacted in its present form. Clause 2(8) together with clause 15(2) and (5) allows the Secretary of State to set a "de minimis" level of activity below which work carried out by defined authorities is exempt from competition. Clause 6(3) together with clause 15(3) and (6) provides for the Secretary of State to phase in the duty to compete, with the limitation that the regulations shall not apply to work to be carried out before 1 April 1989.

2. Although the Bill is still before Parliament the Government believes it is right to set out its proposals on these two important powers now so as both to inform discussion of the Bill itself and to help authorities to plan how best to comply with the Bill's provisions assuming it does become law. There can of course be no guarantee that the proposals set out below will not be amended following Parliament's consideration of the Bill, and in the light of comments on this consultation paper and the separate consultation paper on leisure management which was issued last month.

DE MINIMIS LEVELS

3. A wide variety of views was expressed in response to the consultation paper of February 1985 on the question of de minimis levels, both as regards the level and the form of the relevant threshold. Some respondents felt that thresholds should apply to authorities' defined activities as a whole rather than to each activity individually. This would almost inevitably imply that some individual activities carried out on a fairly large scale would be exempt simply because individual authorities carried out their other activities on a very small scale. It is based essentially on the

premise that small authorities should be exempt, which is not one which the Government would in principle accept. Small authorities are in general just as capable of benefitting from competition as are large authorities.

4. As regards the level, there were those respondents who advocated amounts of expenditure which (whether expressed directly as expenditure or in manpower terms) equated to what would otherwise be regarded as quite substantial businesses. Clearly a de minimis level must be set at a low level of expenditure if it is not to cease to have any rationale.

5. The Government's view, following careful consideration of the views put forward, is that there is no good case for exempting activities currently costing more than £100,000 a year in terms of gross expenditure, and that there is no compelling case for setting different levels for different activities.

6. Such a level could be expressed directly in expenditure terms or in terms of the manpower equivalent, as with the existing DLO regime. A manpower threshold has certain attractions but in the case of at least some of the defined activities it could be difficult to use this approach with any certainty that the numbers set would in fact equate to the desired expenditure threshold.

7. The Government therefore proposes that the threshold should be expressed directly in expenditure terms. In other words defined authorities would be exempt from competition for any one defined activity if the amount they spent on the direct carrying out of the activity - including all relevant overhead costs - was less than £100,000 a year. "Client" costs such as specifying and ordering work, and any other costs which would have to be incurred whether the work was carried out by direct employees or by contractors, would of course not be included in the calculation.

8. Since the competitive tendering process takes some time, authorities will need to know whether they are exempt in any financial year well before the start of that year. The Government therefore proposes that an authority should be exempt in any year if its estimated gross expenditure in carrying out the activity in the previous year is less than £100,000. Framing the exemption in this

way should not give rise to significant problems, because authorities will have set their budgets and rates before they need to work out whether they will be required to expose any activity to competition.

PHASING IN OF COMPETITION

9. Responses to the earlier consultation paper were broadly united in the view that it would be necessary to introduce competition over a period of a few years so as to allow both authorities to cope with the work of specifying and contractors to cope with the work of tendering.

10. Any viable phasing scheme will clearly, therefore, have to avoid either requiring any one group of authorities to seek tenders for all activities at any one time, or requiring any one activity to be the subject of tenders by all authorities at any one time.

11. Some of the responses argued that the Government should phase in competition by progressively increasing the proportion of work which must be competed for. For example, authorities would be required to expose a third of their school meals operation to competition in year one; a further third in year 2; and the final third in year 3. This would mean that authorities would be able to apply lessons learnt in the early years to later tendering exercises. But in order to phase in competition fully in 3 years it would mean that all authorities had to tender part of each service each year. This form of phasing may be appropriate for ground maintenance (see paragraph 12(iv) below), but it would not meet the concerns set out in the previous paragraph. It would also be difficult to police.

12. The number of possible phasing schemes is almost limitless but within these constraints any scheme chosen ought clearly to be as simple as possible. The one which is proposed has the following features:

(i) Activities (other than ground maintenance) are divided into six categories. This is done by treating refuse collection and street cleansing as a single category in view of the argument that they are often suitable for letting as single contracts. Leisrue management is included as the 6th activity on an illustrative basis pending the outcome of consultation.

(ii) Local authorities (other than the Isles of Scilly) are divided into four classes - London boroughs, metropolitan districts, counties, and non-metropolitan districts. This reflects firstly the fact that some classes include a different selection of the six activity categories amongst their functions; and secondly the desirability of ensuring an even geographic spread during the phasing-in period.

(iii) Each local authority class is then divided into either five or six groups (according to how many activities are amongst its functions) based on alphabetic listings. Thus, for instance, Barnsley is in group 1, Birmingham in group 2, Bolton in group 3 and so on. Activities are then phased in one category at a time at 6-monthly intervals for each authority group in turn. For London boroughs and metropolitan districts, since both groups carry out all six activity categories, this means all six activities must have been competed for by October 1991 - 2½ years after the first activity (refuse collection plus street cleansing) in April 1989. For the other two classes of authority competition is fully phased in by April 1991.

(iv) Ground maintenance is phased in over a longer period - 5 years - in view of the particularly limited capacity of the private sector to tender for this work. But all authorities expose some ground maintenance to competition, starting with 10% in the first period and increasing by 10% at 6-monthly intervals.

(v) ILEA - which has only four of the six activity categories amongst its functions - has competition phased in in four stages.

(vi) The Isles of Scilly and all non local-authority bodies are required to subject all of their services to competition right from the start. This is not as onerous as it appears. Some activities - notably refuse collection and school and welfare catering - are not a function of any of the bodies concerned (apart from the Isles of Scilly, which has all functions though it is neither a county nor a district). And as regards the remaining activities, few of the bodies are likely to carry out many of them on a substantial scale, so most are likely to be exempted by a de minimis provision.

(vii) To deal with the possibility of counties or non-metropolitan districts carrying out work outside their main functions on an agency basis it is proposed that any such work carried out by them should be subject to competition from 1 April 1989. Although this will in principle mean some authorities dealing with up to three activities on that date, since such agency agreements are unusual it should not cause significant problems.

DETAILED IMPLICATIONS

13. The matrices at Annexes A - D summarise the proposals for local authority groups and for the other bodies separately. Annex A, for instance, shows that from 1 April 1989 the first group of non-metropolitan districts must expose refuse collection and street cleansing to competition; the second group must expose building cleaning; the third group other catering; and so on. Some ground maintenance work in each authority and body is subject to competition by 1 April 1989, and the proportion builds up so that all ground maintenance work is covered by 1 October 1993.

14. Annexes E and F list the authorities falling into each of the five or six groups as the case may be. Thus for instance group 1 authorities include Adur, Barnet, Avon, and Barnsley. The group sizes are not all exactly equal simply because the numbers in each group do not always divide exactly by five or six.

RESPONSES

15. The Government would be grateful for comments on these proposals by 31 January 1988. These should be sent to:-

Department of the Environment
Room P1/135
2 Marsham Street
London SW1P 3EB

16. Copies of this paper are being distributed to a wide range of interested parties, including individual authorities as well as stheir associations. Further copies are available on request from the address above, or by telephoning 01-212 8287.

NON-METROPOLITAN DISTRICTS: PHASING-IN OF COMPETITION BY DATE AND ACTIVITY

ACTIVITY / DATE	Refuse Collection and Street Cleansing	Building Cleaning	School and Welfare Catering	Other Catering	Vehicle Maintenance	Leisure Management	Ground Maintenance
1/4/89	1	2	All groups	3	4	5	All (10%)
1/10/89	5	1		2	3	4	All (20%)
1/4/90	4	5		1	2	3	All (30%)
1/10/90	3	4		5	1	2	All (40%)
1/4/91	2	3		4	5	1	All (50%)*

Note: Numbers refer to groups of authorities.

*: The proportion of ground maintenance work to be exposed to competition by all groups will continue to increase in 10% steps on 1/10/91, 1/4/92, 1/10/92, 1/4/93 reaching 100% on 1/10/93.

COUNTIES: PHASING-IN OF COMPETITION BY DATE AND ACTIVITY

ACTIVITY / DATE	Refuse Collection and Street Cleansing	Building Cleaning	School and Welfare Catering	Other Catering	Vehicle Maintenance	Leisure Management	Ground Maintenance
1/4/89	All groups	1	2	3	4	5	All (10%)
1/10/89		5	1	2	3	4	All (20%)
1/4/90		4	5	1	2	3	All (30%)
1/10/90		3	4	5	1	2	All (40%)
1/4/91		2	3	4	5	1	All (50%)*

Note: Numbers refer to groups of authorities.

*: The proportion of ground maintenance work to be exposed to competition by all groups will continue to increase in 10% steps on 1/10/91, 1/4/92, 1/10/92, 1/4/93 reaching 100% on 1/10/93.

C

LONDON BOROUGHS AND METROPOLITAN DISTRICTS: PHASING-IN OF COMPETITION BY DATE AND ACTIVITY

ACTIVITY / DATE	Refuse Collection and Street Cleansing	Building Cleaning	School and Welfare Catering	Other Catering	Vehicle Maintenance	Leisure Management	Ground Maintenance
1/4/89	1	2	3	4	5	6	All (10%)
1/10/89	6	1	2	3	4	5	All (20%)
1/4/90	5	6	1	2	3	4	All (30%)
1/10/90	4	5	6	1	2	3	All (40%)
1/4/91	3	4	5	6	1	2	All (50%)
1/10/91	2	3	4	5	6	1	All (60%)*

Note: Numbers refer to groups of authorities.

*: The proportion of ground maintenance work to be exposed to competition by all groups will continue to increase in 10% steps on 1/4/92, 1/10/92, 1/4/93 reaching 100% on 1/10/93.

Other Bodies: Phasing-In of Competition by Date and Activity

(1) Inner London Education Authority

Building Cleaning	1/4/89
School-Welfare Catering	1/10/89
Other Catering	1/4/90
Vehicle Maintenance	1/10/90
Ground Maintenance	10% by 1/4/89 20% by 1/10/89 and so on as for all other authorities

(2) Council of the Isles of Scilly and other bodies*

All defined activities except ground maintenance to be subject to competition by 1/4/89.

Ground maintenance to be exposed to competition on an increasing percentage basis from 1/4/89, as for all other authorities (10% by 1/4/89, 20% by 1/10/89 and so on).

* Other English bodies covered by Part I of the Bill are (see Clause 1 of the Bill):

Urban Development Corporations
New Town Development Corporations
The Commission for the New Towns
Police Authorities
Combined Fire Authorities
Metropolitan and London Fire and Civil Defence Authorities
Metropolitan County Passenger Transport Authorities
Joint Waste Disposal Authorities
Joint Committees set up under Section 101 of the Local Government Act 1972.

LOCAL AUTHORITY LISTINGS (LONDON BOROUGHS AND METROPOLITAN DISTRICTS; 6 GROUPS)

ANNEX F

GROUP 1

London Boroughs	Met. Districts
Barnet	Barnsley
Croydon	Coventry
Haringey	Leeds
Kensington and Chelsea	Rochdale
Redbridge	Solihull
Wandsworth	Trafford

GROUP 2

London Boroughs

Bexley
Ealing
Harrow
Kingston-upon-Thames
Richmond-upon-Thames
Westminster

Met. Districts

Birmingham
Doncaster
Liverpool
Rotherham
South Tyneside
Wakefield

GROUP 3

London Boroughs

Brent
Enfield
Havering
Lambeth
Southwark

Met. Districts

Bolton
Dudley
Manchester
Salford
St Helens
Walsall

GROUP 4

London Boroughs

Bromley
Greenwich
Hillingdon
Lewisham
Sutton

Met. Districts

Bradford
Gateshead
Newcastle upon Tyne
Sandwell
Stockport
Wigan

GROUP 5

London Boroughs	Met. Districts
Camden	Bury
Hackney	Kirklees
Hounslow	North Tyneside
Merton	Sefton
Tower Hamlets	Sunderland
	Wirral

GROUP 6

London Boroughs

Barking and Dagenham
City of London
Hammersmith and Fulham
Islington
Newham
Waltham Forest

Met. Districts

Calderdale
Knowsley
Oldham
Sheffield
Tameside
Wolverhampton

LOCAL AUTHORITY LISTINGS (COUNTIES AND NON-METROPOLITAN DISTRICTS ; 5 GROUPS)

ANNEX E

GROUP 1

Non-metropolitan districts

Adur
Ashfield
Basildon
Beverley
Bolsover
Braintree
Bristol
Burnley
Carlisle
Chelmsford
Chesterfield
Cleethorpes
Cotswold
Darlington
Derwentside
East Devon
East Staffordshire
Ellesmere Port and Neston
Exeter
Fylde
Gosport
Halton
Hart
Hertsmere
Hove
Kerrier
Lancaster
Lichfield
Maldon
Mendip
Middlesbrough
Newbury
North Dorset
North Shropshire
Northavon
Oswestry
Plymouth
Reading
Richmondshire
Rugby
Ryedale
Sedgemoor
Slough
South Hams
South Norfolk
South Somerset
Spelthorne
Stevenage
Suffolk Coastal
Taunton Deane
Tewkesbury
Tonbridge and Malling
Uttlesford
Warrington
Wealden
West Dorset
West Wiltshire
Woking
Wrekin
York

Counties

Avon
Cheshire
Devon
Gloucestershire
Isle of Wight
Norfolk
Oxfordshire
Surrey

GROUP 2

Non-metropolitan districts

Allerdale
Ashford
Basingstoke and Deane
Blaby
Boothferry
Breckland
Broadland
Cambridge
Carrick
Cheltenham
Chichester
Colchester
Craven
Dartford
Dover
East Hampshire
East Yorkshire
Elmbridge
Fareham
Gedling
Gravesham
Hambleton
Hartlepool
High Peak
Huntingdonshire
Kettering
Langbaurgh
Lincoln
Malvern Hills
Mid Bedfordshire
Milton Keynes
Newcastle-under-Lyme
North East Derbyshire
North Warwickshire
Norwich
Oxford
Poole
Redditch
Rochester upon Medway
Runnymede
Salisbury
Selby
South Bedfordshire
South Herefordshire
South Northamptonshire
South Staffordshire
St Albans
Stockton-on-Tees
Surrey Heath
Teesdale
Thamesdown
Torbay
Vale Royal
Warwick
Wear Valley
West Lancashire
Weymouth and Portland
Wokingham
Wychavon

Counties

Bedfordshire
Cleveland
Dorset
Hampshire
Kent
Northamptonshire
Shropshire
Warwickshire

GROUP 3

Non-metropolitan districts

Alnwick
Aylesbury Vale
Bassetlaw
Blackburn
Boston
Brentwood
Bromsgrove
Cannock Chase
Castle Morpeth
Cherwell
Chiltern
Congleton
Crawley
Daventry
Durham
East Hertfordshire
Eastbourne
Epping Forest
Fenland
Gillingham
Great Grimsby
Harborough
Hastings
Hinckley and Bosworth
Hyndburn
King's Lynn and West Norfolk
Leicester
Luton
Mansfield
Mid Devon
Mole Valley
North Bedfordshire
North Hertfordshire
North West Leicestershire
Nottingham
Pendle
Portsmouth
Reigate and Banstead
Rochford
Rushcliffe
Scarborough
Sevenoaks
South Bucks
South Holland
South Oxfordshire
South Wight
St Edmundsbury
Stoke-on-Trent
Swale
Teignbridge
Thanet
Torridge
Vale of White Horse
Watford
Wellingborough
West Lindsey
Wimborne
Woodspring
Wycombe

Counties

Berkshire
Cornwall
Durham
Hereford and Worcester
Lancashire
Northumberland
Somerset
West Sussex

GROUP 4

Non-metropolitan districts

Amber Valley
Babergh
Bath
Blackpool
Bournemouth
Bridgnorth
Broxbourne
Canterbury
Castle Point
Chester
Chorley
Copeland
Crewe and Nantwich
Derby
Easington
East Lindsey
Eastleigh
Epsom and Ewell
Forest Heath
Glanford
Great Yarmouth
Harlow
Havant
Holderness
Ipswich
Kingston upon Hull
Leominster
Macclesfield
Medina
Mid Suffolk
New Forest
North Cornwall
North Kesteven
North Wiltshire
Nuneaton and Bedworth
Penwith
Preston
Restormel
Rossendale
Rushmoor
Scunthorpe
Shepway
South Cambridgeshire
South Kesteven
South Ribble
Southampton
Stafford
Stratford on Avon
Tamworth
Tendring
Three Rivers
Tunbridge Wells
Wansbeck
Waveney
Welwyn Hatfield
West Oxfordshire
Winchester
Worcester
Wyre

Counties

Buckinghamshire
Cumbria
East Sussex
Hertfordshire
Leicestershire
North Yorkshire
Staffordshire
Wiltshire

GROUP 5

Non-metropolitan districts

Arun
Barrow in Furness
Berwick-upon-Tweed
Blyth Valley
Bracknell
Brighton
Broxtowe
Caradon
Charnwood
Chester-le-Street
Christchurch
Corby
Dacorum
Derbyshire Dales
East Cambridgeshire
East Northamptonshire
Eden
Erewash
Forest of Dean
Gloucester
Guildford
Harrogate
Hereford
Horsham
Kennet
Kingswood
Lewes
Maidstone
Melton
Mid Sussex
Newark & Sherwood
North Devon
North Norfolk
Northampton
Oadby and Wigston
Peterborough
Purbeck
Ribble Valley
Rother
Rutland
Sedgefield
Shrewsbury and Atcham
South Derbyshire
South Lakeland
South Shropshire
Southend-on-Sea
Staffordshire Moorlands
Stroud
Tandridge
Test Valley
Thurrock
Tynedale
Wansdyke
Waverley
West Devon
West Somerset
Windsor and Maidenhead
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020

DLG

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

Steven Wood Esq
Private Secretary to
The Rt Hon John Wakeham MP
Lord Privy Seal
Privy Council Office
Whitehall
LONDON
SW1A 2AT

14 October 1987

1. ~~JBA~~
2. NBPR.

Dear Steven,

RATE SUPPORT GRANT SETTLEMENT 1988/89

My Secretary of State proposes to announce his proposals for the 1988/89 Rate Support Grant settlement in a consultation paper to be sent to the local authorities and the associations, probably in the week beginning 26 October. Subject to the Lord Privy Seal's views, he intends to make this announcement in answer to a written Parliamentary Question.

There will no doubt be demands for an oral statement. But there is no precedent for that at this consultative stage. And when the RSG Report is laid, probably in late November or early December, my Secretary of State would propose to make an oral statement setting out the Government's decisions. I should be grateful for confirmation that the Lord Privy Seal is content with that procedure, and agrees that demands for an oral statement in October should be resisted: my Secretary of State feels that three oral statements on RSG (July, October and November), as well as a full-day debate, would be quite unreasonable.

As last year, we will be providing briefing material to the Whips about the settlement, and I am consulting Murdo MacLean separately about that.

I am copying this letter to Murdo MacLean and Rhodri Walters in the Chief Whips' offices, to the Private Secretaries of E(LF) members and to Trevor Woolley in Sir Robert Armstrong's office.

Yours,

R U YOUNG
Private Secretary

Have asked for briefing ~~Questions~~

PC checks how we dealt with briefing last year. We should probably ask RCE for copy of the material at X.

MEA 19/10

This is 100% recycled paper

001/4215

CONFIDENTIAL

cc Dept Mr Evans
cc. B/Mr. Howard
PS/Mr. Chope
B/Sun Sec.
Mr. Bradley
Mr. Sharp
Ms. Roscoe.
Mr Ramsay
Mrs Ramsay
S 15 - to see

Treasury Chambers, Parliament Street, SW1P 3AG

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

DEPARTMENT OF THE ENVIRONMENT
RECEIVED IN
13 OCT 1987
PRIVATE OFFICE

12 October 1987

Dear Nick,

A "STOP" POWER FOR THE DISTRICT AUDITOR

Your letter of 6 October to Willie Whitelaw set out revised proposals for a power that will enable Auditors to stop imprudent financial transactions by local councils. I note that you now envisage the proposed stop power being in reserve on the basis that the Audit Commission are able to secure local authorities support for a self-regulatory approach.

This represents an important and interesting new development in the original concept of graduated response within a prudential regime. I would welcome the opportunity to discuss with you and colleagues this approach to the stop power in detail. More generally, I think we should consider how far you envisage other elements of the prudential regime, such as the overseer, operating within a voluntary or self-regulatory rather than statutory framework.

However, even under the proposed self-regulatory approach, the effectiveness of the scheme would in large part depend upon the development of suitable prudential ratios; and we have yet to see on an empirical basis how the Audit Commission propose to make these work. I understand my officials are meeting yours on 20 October, under the aegis of the Working Group on Local Authority Financial Prudence, to discuss inter alia prudential ratios. I am aware of the time pressures if you are to consult the local authorities and introduce the necessary legislation before Christmas. I therefore hope we will be able to meet and discuss these proposals once our officials have had these further discussions.

I am copying this letter to Willie Whitelaw, other members of E(LA) and Sir Robert Armstrong.

Yours Ever,
John

JOHN MAJOR

CONFIDENTIAL

CC 86

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

C/PSO/10270/87

NBPM

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

-8 OCT 1987

Dear John,

LOCAL AUTHORITY CAPITAL ALLOCATIONS

will request if required

I have seen Nicholas Ridley's letter of 6 October. Similar action to make additional local transport allocations for 1987/8 is equally justified on the evidence to which he refers. The figures, which I understand officials have agreed, forecast a transport underspend of over £120 million. I recognise that £60m of this is not a real underspend because of the element of transport provision included this year simply to increase the capital allocations.

Unfortunately it is already so late in the year that I cannot expect highway authorities to make use of all the extra £60m. of allocations that would be justified. It is difficult to reverse very quickly the cutback in new road schemes starts which local authorities have made in response to the reduced allocations. Road investment also tends to be "front-loaded" in the year because of the effect of adverse weather conditions in the winter months. For these reasons I do not think authorities could make good use of more than about £30 million extra allocations at this late stage. To a large degree the ground lost on the local roads programme by the squeeze in this year's allocations cannot now be regained.

I have asked my officials to undertake a rapid "trawl" to identify cases where authorities could make good use of additional allocations, but they need to be able to contact local authorities quickly for this purpose. If it is to be effective we need, as Nicholas says, to be able to make them as soon as possible. I would therefore be grateful for your early agreement to announcing additional allocations for 1987/8 up to a ceiling of £30m.

CONFIDENTIAL

Copies of this letter go to the Prime Minister, members of E(LA) and to Sir Robert Armstrong.

PAUL CHANNON

CONFIDENTIAL

Distribution.

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Your ref:

6 October 1987

Dear Lord President,

A "STOP" POWER FOR THE DISTRICT AUDITOR

Thank you for your letter of 23 July agreeing to the inclusion in the Local Government Bill of my proposal to give the auditor pre-emptive powers to stop unlawful acts by local authorities. This was supported by John Major and Wyn Roberts and I shall be sending instructions to Parliamentary Counsel shortly.

John and Wyn shared your view that a collective discussion would be helpful on the second part of the proposal, enabling the auditor to deal with acts that are highly imprudent but not at present illegal. As it happens the Audit Commission has recently expressed some further thoughts on the way forward with the prudential regime which have given me cause to reconsider the form of the legislation on the second part my proposal. The Commission's intention is to launch consultation with local government and the accounting profession on a system of prudential ratios during the autumn. This will be presented as a voluntary initiative in self-regulation by local government; as David Cooksey, the Chairman, has been saying publicly, it will represent an opportunity for local government to put its own house in order so as to avoid the need for further controls by central government.

Whilst I still seek your agreement to proceed with the inclusion of stop power, part 2, in the Local Government Bill I now think it would be better to provide for it to come into effect only if and when an appropriate order was made.

I believe that prudential ratios represent a promising development and I would like to give local government every encouragement to make them a success as the basis of a system of self-regulation. I therefore propose to make known when I introduce the provisions on part 2 in the Bill that I will refrain from making the order to bring them into effect provided that local government moves speedily towards self-regulation. I am sure that this reserve power will act as a spur to progress. But if that progress is lacking, the order can be made putting in place the powers to allow the auditor to take action against authorities who continue irresponsibly piling up forward commitments.

he new duty on local authorities to balance the interests of various groups which I had proposed and which was set out in my letter of 17 July was framed in very wide terms. I think it would be difficult presentationlly and politically to enact a general duty of this kind with the express intention of holding it in reserve. It could also create problems in the courts to have in reserve a duty which local authorities are in part required to abide by anyway as part of their common law fiduciary duty. The reserve power I am now proposing will be defined in much narrower terms. This is described at greater length in the annex to this letter. It would simply require local authorities to abide within such levels of future commitments as I may specify in regulations. If local government signs up to a voluntary system of ratios which works well in practice, then no action need be taken. If, on the other hand, the Audit Commission initiative on prudential ratios fails to gain local government backing, I could then make regulations on the matter setting out my own criteria for prudence or I might require the Commission to produce a set of prudential ratios, which I could then adopt in regulations.

I believe that provisions defined in these narrower terms would not raise any fundamental questions of legal principle nor present the same enforcement difficulties in the courts to which the wider duty might have given rise.

We have discussed our thinking with the Chairman of the Audit Commission who believes that a reserve power along these lines would fit well with what the Commission has been saying about the need for local government to put its own house in order.

I hope that if necessary we can meet with colleagues as soon as possible after the Conference to discuss these proposals so that we can work up instructions to Parliamentary Counsel and consult local government in time for introduction at Report stage.

I am copying this letter to members of E(LA) and to Sir Robert Armstrong.

Yours sincerely,

Rly

NICHOLAS RIDLEY

(Approved in draft by the Secretary of State and signed in his absence.)

Annex

CONFIDENTIAL

RESERVE POWER AGAINST LOCAL AUTHORITY FINANCIAL IMPRUDENCE

It is proposed that a power be introduced into the present Local Government Bill to ensure that there is an effectual means of preventing local authorities over-committing themselves: it is intended that this should be a reserved power to be exercised only if local government's own attempt to set effective standards of financial prudence should fail.

2. The power would enable the Secretary of State to make regulations which local authorities would have to comply with. These regulations would define the limits of financial prudence. Failure to comply with the prescribed limits would be the basis upon which the Treasurer would act (under the duties we are laying upon him in the Rates Reform Bill) or the auditor could act to restrain the authority from over-committing itself (under the powers we are giving him stop an authority incurring unlawful expenditure).

3. The Secretary of State might prepare his own regulations or the Audit Commission might be required to submit proposals to him for financial prudence which the Secretary of State might provide for by order.

4. The limits of financial prudence defined under the regulations would be likely to be in terms of prudential ratios: ratios between financial commitments and means to meet them. But the proposed power would not prevent other possibilities.

At the moment work is going forward, under the leadership of the Audit Commission, on the development of prudential ratios for local authorities as a means of self regulation. If this voluntary initiative is successful, potential lenders and the authorities' electors would be put on public notice when an authority exceeded or is in danger of exceeding these limits of prudence.

6. Our new power would be used if the local government world fails to produce an effective system of prudential ratios, or if authorities were to ignore or evade such ratios. There is a precedent for the use of a reserve power in this way in the Financial Services Act which empowers the Secretary of State to make rules where it appears to him that a professional body has failed itself to make rules or issue guidance. The existence of this reserve power in the Bill would be calculated to concentrate local governments' attention on ensuring that a voluntary system is devised and made to work.

7. The necessary technical basis of calculation for the accounting concepts needed to express financial prudence is being taken forward from the basis provided by the voluntary accounting code introduced by the local authority world this year (under threat of regulations being introduced if their progress is not satisfactory). In particular, the concept of the financial commitments of a local authority is being clarified in the further work on capital accounting and in our own work on capital controls.

CONFIDENTIAL

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

The Rt Hon Paul Channon MP
Secretary of State
Department of Transport
2 Marsham Street
LONDON
SW1P 3EB

30 September 1987

Dear Paul

PTAs UNDER THE NEW LOCAL GOVERNMENT REGIME

Thank you for your letter of 6 August in which you suggest that officials should consider further your proposal to change PTAs from precepting to billing authorities. Officials have now met and a note summarising their views is attached.

The conclusions are as follows:-

a. the proposal enhances accountability to the extent that individual districts can influence expenditure decisions of PTAs. Where districts have little influence on the PTA accountability is increased only if the district can secede from the PTA. Secession is possible under existing legislation, although it may be difficult with the present role of PTAs supporting local rail services.

b. the proposal does not resolve problems with GREs. The inadequacies of the current methodology would merely be transferred from PTAs to metropolitan districts. Whereas the proposal would mean that PTAs could not be selected on the basis of "inadequate" GREs for community charge capping, any worsening of the needs assessments for districts would provide a less reliable basis for capping districts.

c. neither accountability nor secession are seen as real issues concerning police or fire joint boards.

d. careful public presentation of the proposals would be needed for the change so soon after the creation of PTAs. The change in circumstances - particularly as a result of bus deregulation - would need to be stressed as would the scope for districts to secede. It would also be necessary to demonstrate why similar arrangements were not being recommended for police and fire boards.

The case for changing the status of PTAs from precepting to billing authorities rests crucially on whether accountability will really be improved. I remain concerned that this will not be the result: PTAs themselves will be one step further removed from scrutiny by the community chargepayer and individual districts

will always be able to claim that they did not have a decisive voice in PTA affairs, unless secession is a realistic option for them. But if, as you argue, districts are the right level at which to assign responsibility for decisions on public transport expenditure - and secession is a realistic option - then it seems that the presentational and the political advantages lie in abolishing PTAs altogether and giving metropolitan district councils full responsibility for public passenger transport matters. (If districts wished they could still set up joint committees to co-ordinate transport policy across wider areas.) Abolition would significantly strengthen accountability arguments. Moreover grasping the nettle and abolishing PTAs altogether should be easier to present to the public than a change to billing authority status. There would also be a clearer justification for dealing with PTAs differently to police and fire joint boards. I would certainly wish to see this option fully explored before agreeing to the change in precepting status that you suggest.

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

NICHOLAS RIDLEY

THE TREATMENT OF PASSENGER TRANSPORT AUTHORITIES UNDER THE NEW LOCAL GOVERNMENT FINANCE REGIME

1. The Secretary of State for Transport has proposed that the forthcoming Local Government Finance Bill should include provisions to change the financial relationship between PTAs and metropolitan districts from precepting to billing. The effect of the change would be:-

(i) that no PTA precept would appear on the charge payer's bill;

(ii) rather their expenditure and needs assessment would be included in the budget and GRE of each metropolitan district, but would not be separately identifiable.

The Secretary of State for Transport argues that this change is necessary if spending decisions of PTAs are more closely to reflect the wishes of the electorate under the community charge scheme. This requires greater accountability through the ballot box which, in metropolitan areas, is only exercised in voting for district members. Ministers have already agreed that GREs should be simplified under the new grant arrangements, and are looking for an approach that will command widespread acceptance as realistic assessments of need. This is more likely to be achieved if the GREs are included within district assessments rather than having separate assessments for PTAs.

2. This note sets out the main considerations for and against the Secretary of State's proposal.

Accountability

3. PTA members are not directly elected, but are appointed by constituent districts, so with existing precepting powers there is no direct accountability of the PTA to the electorate other than through district elections. One drawback of the present precepting arrangements is that it enhances the PTAs' independence and allows districts

to distance themselves from PTA expenditure for which their members are collectively responsible. Changing the status of PTAs to billing authorities would strengthen the link between expenditure and the ballot box because electors would rightly conclude that the only way they can influence this expenditure is through their vote in district elections. Awareness of this should encourage districts to consider the level of public transport expenditure and require their representatives to represent the district's point of view in PTA discussions.

4. On the other hand, it is not obvious that this accountability can operate effectively unless electors have the necessary information on which to judge how much PTAs are spending. Electors would depend on information provided about their district's budget which normally accompanies the local tax demand. However, under the DTP proposal, charge payers would not be able to distinguish from their community charge note the budget of the PTA or the need to spend on public transport. So overspending by a profligate PTA would appear solely as the responsibility of the constituent districts, whereas in practice individual districts may have very little influence over the collective decisions of a PTA.

5. The DTp proposal therefore only enhances accountability to the extent that individual districts can influence expenditure on passenger transport support and concessionary fares. Individual districts do have the opportunity to take their own decisions on spending on these matters by seceding from the PTA. This is possible under Section 42 of the Local Government Act 1985, and the change to a billing arrangement may encourage districts to consider this step. Under the legislation districts may secede from all or any of the functions of the PTA, with the consent of the Secretary of State for Transport. Secession is however difficult at present with the role of PTAs supporting provision of local rail services.

GRE Issues

6. Present GRE arrangements have not produced assessments that command general support as indicating relative need to spend by PTAs in order to provide a standard level of service. Proposals to simplify GREs would, if anything, be likely to worsen the problem if separate assessments were still to be produced for PTAs. While it is reasonable to expect authorities with a wide range of functions and GREs to absorb a certain amount of rough justice, on the grounds that losses from some GREs would be offset by gains on others, the PTA as a single service authority is dependent on only one or two current expenditure GREs.

7. Against this, transferring public transport GREs to districts would not resolve the inadequacies of the methodologies: rather it would worsen the needs assessments of districts and thereby provide a less reliable basis for charge capping districts. The problems of producing realistic needs assessments for public transport need to be properly addressed and not swept under the carpet. The additional responsibilities of PTAs for supporting rail services would be difficult to handle in district GREs, which adds weight to reconsider these responsibilities. The GRE issue needs to be resolve whatever arrangements are finally determined for financing PTAs.

Community Charge Capping

8. If PTAs continue to precept they will fall within the proposed community charge capping regime. Where selection was based on year-on-year increase in the precept there would be no difficulties. To the extent that GREs were perceived to be inadequate they would be criticised as a poor basis for selection in relation to absolute levels of spending. We could, however, seek to adjust the principles for selection to reflect this.

9. If PTAs move to billing they will escape capping, unless special arrangements are made to include them alone among billing authorities in the capping scheme, and their spending and GRE will fall to be considered in selecting the districts

for capping. The districts would then suffer from any perceived inadequacy in the GRE in so far as this could not be reflected in the principles for selection. In addition districts could argue that their representatives, if in a minority, were not reponsible for PTA spending decisions which could push them into capping.

Implications for other joint boards and ILEA

10. The considerations that have led to the proposed change in status of PTAs do not necessarily apply to police and fire joint boards and to ILEA. Although members of the police and fire boards are, as for PTAs appointed by constituent councils - with, for police boards, the addition of members nominated by the joint magistrates committee - accountability is not seen as a real issue. No such issue arises with ILEA as its members are directly elected. For neither police nor fire joint boards is secession by constituent districts regarded as a realistic option in terms of the operational efficiency of the services. Nor has the question of secession from these boards on financial or accountability grounds been seriously raised. Further, the mismatch between GREs and actual spend is less of a problem for the police and fire joint boards than with PTAs, although it is still a matter of real concern in respect of the fire joint boards. It is hoped, however, that further work on the fire GRE will produce more acceptable assessments. The police and fire joint boards would therefore not feel obliged to follow the PTAs if they were to adopt a billing rather than a precepting arrangement.

Public Presentation

11. If this proposal were to proceed, it would require careful presentation, especially on why different arrangements were desirable for PTAs than for other joint boards, and why the position had changed since PTAs were established in 1985. It would be necessary to stress that the position of the PTAs was now different as a result of bus deregulation which meant that they no longer provided a full public transport operation, but simply provided finance for services that would not otherwise be provided by commercial undertakings. If

arguments on accountability were to be used, it would be necessary to play up the possibilities of secession from PTAs and to draw a distinction between PTAs and other joint boards. Withdrawal of responsibilities for local rail services would strengthen the public case for the change.

12. One potential presentational difficulty would be to explain why it was necessary to retain PTAs at all if circumstances had changed so radically that prime responsibility for decisions on public transport expenditure rested at district level rather than at county level.

25 September 1987

LOCAL GOVT – Relations. PL-33

cc BG

NORTHERN IRELAND OFFICE
WHITEHALL
LONDON SW1A 2AZ

SECRETARY OF STATE
FOR
NORTHERN IRELAND

CDJ
21/9
CDT

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

18 September 1987

Dear Chief Secretary

GRANTS FROM THE EUROPEAN COMMUNITY IN RESPECT OF CURRENT EXPENDITURE BY LOCAL AUTHORITIES

Thank you for sending me a copy of your letter of 10 August to Nicholas Ridley on the above subject. The Treasury paper circulated with it contains a fresh option which opens up a direct Northern Ireland interest in the outcome of this issue.

The key point is that while, as my officials have previously indicated, Northern Ireland has at present no local authority expenditure of a relevant type, other bodies, some outside the public sector, have applied for Article 15 aid. Therefore, if we decide, as I think we should, to implement option 5 - which involves explicitly disregarding these receipts on a de minimis basis - I would want to have your agreement that such treatment would also apply to Northern Ireland Article 15 receipts going to the private sector. Option 2 in the paper is unacceptable to me since it would require PE offsets on programmes not associated with the sectors being aided and which have a higher priority in overall public expenditure terms. A realistic assessment of the bids made to the European Commission on behalf of Northern Ireland agencies suggests that about £1m will be earned over the 3 years 1987/88 to 1989/90 by private sector bodies such as Queens University, Belfast and the Northern Ireland Small Business Institute.

I recognise fully the importance of public expenditure considerations, and I understand your preference for option 2. However the situation in this case is not unlike some of the other instances in which colleagues have agreed to treat ERDF aid as de minimis, and on balance, I favour a pragmatic approach - implementation of option 5.

My officials will brief yours on some detailed aspects of the Northern Ireland position but I would appreciate having your agreement that a decision to treat this class of receipts as de minimis will apply to Northern Ireland.

Copies of this letter go to the Prime Minister, David Young, Peter Walker, Malcolm Rifkind, Norman Fowler, Geoffrey Howe, Nicholas Ridley and to Sir Robert Armstrong.

Yours sincerely

G. H. H. Smith

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

SMN/284

LOCAL GOVT

RELATIONS

PT 33

RESTRICTED

cc BG.

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215)
GTN 215) 5147
(Switchboard) 01-215 7877

From the Chancellor of the Duchy of Lancaster and Minister of Trade and Industry

THE RT HON KENNETH CLARKE QC MP

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

CAP.

17 September 1987

Dear John.

You wrote on 10 August to Nicholas Ridley about grants from the European Community in respect of current expenditure by local authorities.

I agree with you that an early resolution of this problem is essential but I do not think you have put forward the best answer. The problem is to reconcile local political pressure with public expenditure considerations, while avoiding exposing any further to the European Commission the embarrassment of our position. I suggest we agree to treat a maximum of say £10 million (net of the saving in Exchequer grant) as "de minimis", and resolve to reconsider the matter if and when that amount has been fully committed, possibly in 1990.

If a meeting proves necessary, I will be ready to join it.

I am copying this letter to the Prime Minister, David Young, Peter Walker, Malcolm Rifkind, Tom King, Norman Fowler and Geoffrey Howe; and to Sir Robert Armstrong.

Yours ever,

KENNETH CLARKE

SE2ADE

Locke Court

Relators

PT32

CONFIDENTIAL

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The Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1

7 September 1987

Dear John

GRANTS FROM THE EUROPEAN COMMUNITY IN RESPECT OF CURRENT EXPENDITURE BY LOCAL AUTHORITIES

I have seen your letter of 10 August about Article 15 of the European Regional Development Fund and Nicholas Ridley's reply of 7 September.

I agree with Nicholas Ridley that local authorities should now be allowed to claim under Article 15. To make off-setting savings from Central Government programmes seems to be cutting off our noses to spite our faces. Local authorities' spending would not be directly controlled, and we would take the impact on Government spending programmes that we probably value more. If we are really concerned about this small gap in our public spending control, we should be willing to contemplate taking powers to act directly on local authority current expenditure - if need be, as Nicholas Ridley suggests, in the reform of the Local Government finance system.

I would be happy to join in a meeting if necessary.

I am copying this to the recipients of your letter.

Yours Norman

NORMAN FOWLER

CONFIDENTIAL

LOCAL GOVT: relations pt 33

PROFESSOR GRIFFITHS

11 September 1987

cc MR STREDDER
MR NORGROVE

CBI: LOCAL GOVERNMENT FINANCE

I had a call from John Banham at the CBI earlier this week. He said that the CBI now had what he thought were some very useful and practical suggestions to make on how the operation of the business rate and community charge could be implemented in a way that increased their impact in increasing the accountability of local Government. In view of the sensitivity of this area, he did not propose to pursue their suggestions in public debate - as the IOD have - but preferred to feed them in privately. Assuming they are agreed by the CBI council next week, he will therefore put them formally to Michael Howard and will also ensure that we receive a copy.

I said that while the framework and principles were clearly no longer open for discussion, we would welcome any constructive ideas that might enhance the end objective of greater accountability. A private rather than a public dialogue would also be more constructive.

Nora Blackwell

DN/OCT4

016

CC/39

From the Minister of State
for Local Government

Department of the Environment
2 Marsham Street
London SW1P 3EB

Telephone 01-212 3434

Prime Minister 2 cc Tony Robinson.

DCS
10/9.

7th September 1987

Dear Sydney

When you came to see me on 30 July with Councillor Pym and John Marshall to discuss Barnet's RSG, I promised to let you have a note explaining why Barnet's grant as a proportion of their expenditure had declined more steeply than Bromley's.

I enclose a note which my officials have prepared on this. As you will see it appears that between 1982/83 - which is the earliest year for which we have access to comparable figures - and 1987/88 any additional loss of grant from Barnet has been chiefly due to their own decisions on spending. The Council have consistently spent more than their GRE and this has meant they have received less grant than they otherwise would have. By comparison Bromley have kept their spending down and their grant up. The table in paragraph 3 shows that if both Boroughs had spent at around GRE they would have lost grant at about the same rate, so the system itself would have treated the two Boroughs evenly.

We have also looked at the level of Barnet's GRE which is higher than Bromley's in total and per capita; this also applies to the Education and Personal Social Services GREs about which Councillor Pym was concerned.

The reason why the absolute levels of grant for the two Boroughs is different is, as I explained, the resource equalisation effect of the present RSG system. This does bear heavily on high rateable value areas like Barnet and that is one of the reasons we want to get rid of this system. Under the new grant system an authority's grant will be set at the beginning of the year and will not be affected by their actual spending. So the two things which cause problems for Barnet now, the link between grant and spending and resource equalisation will not affect grant once the new system is in full operation. As you will appreciate, there is not much that can be done to help before then, but I will be bearing in mind the position of Barnet and other outer London Boroughs when we come to discuss the details of the RSG Settlement.

At our meeting you also mentioned that the Council would like to be able to spend at least part of the receipt from the sale of an interest in the Brent Cross shopping centre. You and Councillor Pym seem to feel that you cannot spend any of it under the present rules. It is a little difficult for me to offer advice without knowing more of the details, but Mr Pym may like to ask his officers to get in touch with mine to discuss whether there is scope for some spending within the rules. Mrs Lesley Creedon on 212 4704 will be able to help.

I am copying this letter to the Prime Minister, John Marshall, John Gorst and Councillor Pym.

Yours ever

Michael

MICHAEL HOWARD

Sydney Chapman Esq MP

BLOCK GRANT ENTITLEMENT : LONDON BOROUGHS OF BARNET AND BROMLEY

1. At a meeting with a delegation from the London Borough of Barnet it was suggested that while the block grant received by Barnet as a proportion of its expenditure had declined from 52% to 29% between 1980/81 and 1987/88, the grant received by Bromley had declined less sharply from 57% to 42%. This note compares the grant entitlements of the two Boroughs over this period and explains the reasons for the differences.

2. The amounts of Block Grant paid to each Borough over the period were as follows:

	Barnet			Bromley		
	Spend £m	Grant £m	%	Spend £m	Grant £m	%
1981/82	£89.583	£32.549	36%	£91.187	£42.977	47%
1982/83	£93.951	£35.581	38%	£88.398	£42.998	49%
1983/84	£97.163	£33.442	34.5%	£92.35	£42.795	46%
1984/85	£98.668	£31.475	32%	£94.149	£41.788	44%
1985/86	£103.843	£33.751	32.5%	£98.003	£41.767	43%
1986/87	£128.547	£38.684	30%	£114.046	£52.373	46%
1987/88	£138.342	£35.370	26%	£120.801	£52.22	43%

Bromley have consistently received a higher percentage of grant, and this percentage has not continued to fall steadily in recent years as it has for Barnet.

3. However, a possible explanation for this is that Bromley's spending has consistently been below or very close to GRE, while Barnet's has been above GRE thus increasing Bromley's grant and reducing Barnet's. For spending at the level of GRE, grant would have been paid at the following levels:

	Barnet			Bromley		
	GRE £m	Grant for spending at GRE £m	%	GRE £m	Grant for spending at GRE £m	%
1982/83	£93.184	£35.586	38.2%	£90.393	£43.354	48%
1983/84	£93.683	£33.379	36%	£93.007	£42.703	46%
1984/85	£94.527	£31.489	33.3%	£94.060	£41.772	44.4%
1985/86	£102.522	£33.974	33%	£98.582	£40.565	41.1%
1986/87	£124.204	£42.191	34%	£117.625	£50.675	43%
1987/88	£129.531	£41.919	32.4%	£123.508	£50.977	41.3%

Barnet's grant would thus have declined from 38.2% to 32.4% and Bromley's from 48% to 41.3% over this period, so had Barnet's expenditure been closer to their GRE the decline in grant percentage would have been similar to that experienced by Bromley. The divergence is due to the Borough's spending decisions.

4. Barnet's GRE is and has been higher than Bromley's both in £m and in £ per head:

	Barnet		Bromley	
GRE	£m	£ per head	£m	£ per head
1981/82	£88.880	£306.06	£87.349	£300.48
1982/83	£93.184	£322.21	£90.393	£311.38
1983/84	£93.683	£316.28	£93.007	£310.44
1984/85	£94.527	£320.65	£94.060	£315.74
1985/86	£102.522	£348.24	£98.582	£329.49

1986/87	£124.204	£416.51	£117.625	£394.19
1987/88	£129.531	£430.05	£123.508	£414.60

The Education and Personal Social Service GREs for 1987/88 are

	£ per head	£ per head
Education (total)	231.83	227.88
PSS (total)	58.10	50.13

5. The preceding paragraphs suggest that the differing trend of grant percentages for the two Boroughs is due to their spending patterns. The main reason for the absolute difference in grant levels is resource equalisation. Grant is calculated in such a way as to enable authorities to provide comparable standards of service by levying similar rates in the pound. However at a given rate poundage level an authority with a high rateable value will be assessed as being able to raise more from its ratepayers; it will therefore get less grant than a low RV authority for the same level of expenditure and GRE. Resource equalisation reduced Barnet's grant entitlement in the 1987/88 Settlement by about £15m, but Bromley's by only £200,000. If the grant system operated without resource equalisation, grant as a proportion of spend at GRE in 1987/88 would have been approximately:

Barnet			Bromley		
Spend at GRE £m	Grant £m	%	Spend at GRE £m	Grant £m	%
129.5	56.9	43.9	123.5	51.2	41.5

6. The difference in the level of block grant support for Barnet and Bromley is therefore due to two factors: first, spending decisions by the Boroughs which reduce Barnet's grant and increase Bromley's and second, resource equalisation which accounted in 1987/88 for a transfer from Barnet's grant of nearly £15m more than the transfer from Bromley's grant.

CONFIDENTIAL

CaB4

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

The Rt Hon John Major Esq MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1

CDF
000 8/9

7 September 1987

Dear Chief Secretary,

GRANTS FROM THE EUROPEAN COMMUNITY IN RESPECT OF CURRENT EXPENDITURE BY LOCAL AUTHORITIES

Thank you for your letter dated 10 August, covering a note prepared by officials specifically concentrating on receipts from the ERDF for Article 15 activities.

The public expenditure treatment of these receipts has remained undecided for more than two years, a situation increasingly difficult for the Government to defend. Further, Article 15 grants are now seen by the Commission as a necessary trigger for the granting of much larger ERDF sums for capital works. If we do not begin to accept Article 15 applications, certain ERDF programmes which draw down very substantial amounts of infrastructure grant are most unlikely to receive Commission approval. We need to remove this threat to the United Kingdom's ability to secure ERDF grants. For both these reasons I support your suggestion that, if at all possible, we should resolve this matter quickly on the lines of the alternatives mentioned in your letter.

While I share your concern with public spending levels, as the paper notes there are two principal objectives to be secured - maximising receipts and as far as possible financing planned expenditure programmes with those receipts. I feel that the option you propose fails on both counts. There is a disincentive for the Departments concerned to handle Article 15 applications and planned Government programmes would be cut back at the expense of unrelated local authority spending. What is needed is an approach that balances the achievement of the two objectives.

The sums involved in Article 15 receipts are small in comparison to other receipts from ERDF and minute in comparison to the totality of local authority expenditure. Receipts are also effectively limited by the ERDF regulation itself. In view of this my feeling is that we should treat Article 15 receipts as "de minimis" for the present. I estimate that receipts in 1989/90 will be in the range of £5m to £10m for the UK as a whole. The suggestion that receipts could have been as high as £30m in 1986 misconstrues the ERDF Regulation, the relationship between applications and receipts and the ability of the Departments concerned to influence the flow of both.

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Moreover a substantial part of Article 15 receipts will be offset by the consequential reduction in Aggregate Exchequer Grant. Since AEG is determined in relation to relevant expenditure which is calculated net of EC receipts, Article 15 grants of, for example, £10m would reduce relevant expenditure by the same amount. Therefore AEG would itself be reduced by £46m, assuming 1987/88 grant percentage of 46%. The remaining amount hardly seem to constitute a very large loophole in public expenditure controls. Rather, this sort of relaxation would be beneficial in permitting this country to receive the much larger ERDF grants available for capital works. The domestic policy implications of failure to attract funding will become of greater relevance when the ERDF becomes more slanted towards inner city areas as currently proposed by the Commission (after British lobbying).

In view of the amounts involved, particularly after their effect on AEG has been taken into account, I feel that your suggestion that Departments find offsetting savings from elsewhere in their own programmes is neither necessary nor appropriate. This would only be possible if you were to provide us with a notional sum of say £10m, from which we would "save" each time an ERDF grant was made, and hand it back to the Treasury!

I fully share your other concern that we must minimise the Commission attempts to influence domestic spending priorities. We would not achieve this by the offsetting savings option, rather the reverse. Such a policy would oblige spending Departments to make reductions in their own programmes which have an agreed domestic priority, in order to cover grant awards made by the Commission. This hardly meets the agreed policy objective of using Commission resources to finance planned programme expenditures.

Moreover, as the paper notes, there are few if any analogous domestic programmes which could be raided in this way. Departments would be forced to make arbitrary cuts in unrelated areas. It is not at all clear which programmes in which Departments would be affected by your proposal and requests to your officials to identify such programmes have failed to elicit a practical response. I really do not think it either reasonable or responsible for me to assent to such a vague proposal without knowing its consequences.

It appears that your concern with the "de minimis" option is less a matter of the level of receipts anticipated by 1989/90, but rather the possibility of a substantial further growth thereafter. As you know the future of the EC's Structural Funds (including ERDF) is under review, although my present reading of the expansion of resources proposed does not suggest any significant increase in the UK's receipts. By next year we should know what role measures of the Article 15 type will have in the recast Fund.

Equally, we are reforming local government finance. We can wait to see if the level of Article 15 receipts eventually merits enough concern to be built into the new system. A case by case approach

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probably involving retrospective PES adjustments between Departments would be costly to administer. As is so often the case when EC and domestic expenditures interact, I feel that the approach you advocate risks becoming an administratively difficult sledge hammer to crack a small and time-limited nut.

I would hope that on the above basis you can agree to our treating these receipts as de minimis for the present, while officials keep the situation under review. In two years time, if it is required, we will have a much more factual base - both about the level of Article 15 receipts and the activities the grants are supporting - to devise a system of reducing the public expenditure implications, linked to both a changed ERDF regulation and local government finance system.

If you would like to discuss further, I would be happy to attend a meeting with other interested colleagues. I understand that some of these colleagues share my concern over your proposals and I am copying this letter to the Prime Minister, David Young, Peter Walker, Malcolm Rifkind, Tom King, Norman Fowler, Geoffrey Howe and Sir Robert Armstrong.

Yours sincerely,

Deborah Lamb

pp. NICHOLAS RIDLEY
(approved by the Secretary of State in draft, signed in his absence.)

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LOCAL GOVT

RELATIONS

PT 33

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01-270 0538 (Llinell Union)
Oddi wrth Ysgrifennydd Gwladol Cymru

The Rt Hon Peter Walker MBE MP

WELSH OFFICE
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Tel. 01-270 3000 (Switchboard)
01-270 0538 (Direct Line)
From The Secretary of State for Wales

27 August 1987

CONFIDENTIAL

GRANT FROM THE EUROPEAN COMMUNITY IN RESPECT OF CURRENT EXPENDITURE BY LOCAL AUTHORITIES

Thank you for copying to me your letter of 10 August to Nicholas Ridley on the treatment of receipts under Article 15 of the European Regional Development Fund (ERDF).

I agree that we need to reach decisions on this with some urgency given that the issue is a longstanding one on which local authorities, other sponsors and the Commission are getting increasingly restive.

The absence of decisions is also adding to the difficulties of drafting and negotiating EC programmes which are likely to become the main channel for EC aid whether we like it or not. The omission of an Article 15 element in such programmes also, of course, means that we are running the risk of, at the very least, delaying decisions on some millions of pounds of prospective grant through our apparent unwillingness to take on board Article 15 expenditure of comparatively modest proportions. In the case of the Dyfed, Gwynedd, Powys Integrated Operations Programme for example some £108m in grant is at stake.

Your letter poses two options for dealing with this situation one of which, namely making offsetting changes to central government programmes, would present me with some difficulty since I have no analogous programmes against which to make such savings. The net result of pursuing that route in Wales would, therefore, in effect amount to an arbitrary offset against other unrelated expenditure programmes, covering say health, education or economic development in order to compensate for EC grants to local authorities which would in turn support private sector developments. This would clearly be difficult to justify even if it were possible. Because of the difficulty in forecasting accurately the level of EC receipts likely in any one financial year it would also result in an inefficient use of departmental resources, particularly if adjustments were sought in subsequent years.

The Rt Hon John Major MP
Chief Secretary to the Treasury

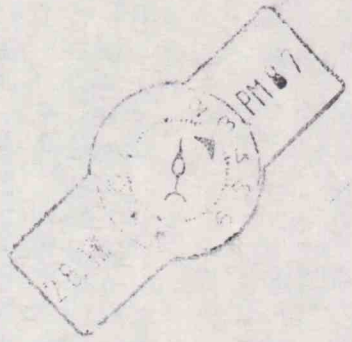
/For my ...

For my part, therefore, the de minimis route seems to me to be the only practical solution, the moreso since the sums involved are likely in the immediate term to be insignificant when viewed against the totality of local authority expenditure and are anyway already in part taken into account when relevant expenditure is being determined.

If and when this ceases to be the case then we might, of course, need to look at the situation again. A reconsideration of our arrangements for the treatment of EC receipts may anyway well turn out to be necessary as the effects of the changes introduced by the Single European Act and the ongoing Structural Funds review work their way through with possible effect on our levels of EC receipts across the board. For the present, however, I hope that you will agree that the balance of interest lies in the early resolution of this issue and that this will indeed prove possible on the basis of the present correspondence.

If, however you feel that a discussion would be useful - either at an ad hoc meeting or at E(A) - then I would be ready to participate. Copies of this letter go to the Prime Minister, David Young, Malcolm Rifkind, Tom King, Norman Fowler, Geoffrey Howe and to Sir Robert Armstrong.

LOCAL GOVT: Relations PT33



cc/86

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
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My ref:

Your ref:

Mark Addison Esq
Private Secretary to
The Prime Minister
10 Downing Street
LONDON
SW1A 2AA

17 August 1987

Prime Minister (2)
To note that DoE will provide an assessment of the usefulness of the discussions before making any permanent arrangements.
MEA 19/8

Dear Mark,

CONSULTATIONS WITH LOCAL GOVERNMENT

Thank you for your letter of 6 August.

As my Secretary of State's letter of 4 August to Kenneth Baker explained, the proposal for discussions in a smaller forum than CCLGF about the future of local government was an initiative from the local authority associations which was urged at the last meeting of the CCLGF by Councillor Chatfield (Conservative) of the ACC and Councillor Beecham (Labour) of the AMA. My Secretary of State is by no means convinced that such discussions will prove useful, but in view of the strong desire on the part of some members of some of the associations (of both Parties) to adopt a more constructive and less adversarial approach to central/local government relations, he considers it appropriate to respond positively.

We are still waiting to hear whether the associations will accept the terms which he proposed for a first meeting, probably in October or November. These were that the meetings should be small and not reported to the Press. If they do agree then much will depend on the outcome of the first meeting. We shall, of course, provide an assessment for the Prime Minister of the usefulness of the discussions before making any permanent arrangements, as requested.

I am copying this letter to the Private Secretaries to the Lord President, the Home Secretary, the Secretaries of State for Employment, Social Services and Transport, the Chancellor of the Duchy of Lancaster, the Chief Secretary, the Minister for the Arts and to Sir Robert Armstrong.

Yours,
Robin.

R U YOUNG
Private Secretary

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LOCAL COUT : Relations PT33

CCBG

SECRETARY OF STATE FOR EDUCATION AND SCIENCE

ELIZABETH HOUSE
YORK ROAD
LONDON SE1 7PH
01-934 9000

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

12 August 1987

Dear Nick

CONSULTATIONS WITH LOCAL GOVERNMENT

Thank you for your letter of 4 August.

It is helpful to know of your plans to discuss broad local government issues with a few local authority people. I shall in the meantime be talking to the education representatives of the Associations myself about the planned changes in education policy.

I am copying this letter to recipients of yours.

Does this mean that eventually you will be able to dispense with CCLGF - Disposed, as a solemn pantomime.

Yours ever

Kenneth

005/3298

CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG

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

10 August 1987

Dear Secretary of State,

GRANTS FROM THE EUROPEAN COMMUNITY IN RESPECT OF CURRENT EXPENDITURE BY LOCAL AUTHORITIES

You will recall that John MacGregor agreed that the Treasury should take over this issue because of the difficulty which the Department of the Environment was having in handling it. My officials have now prepared the attached paper in consultation with officials from your Department and those of the other Departments concerned. Shorn of its complexity, it invites us to decide between maintaining or relaxing Government policy effectively to control the public expenditure consequences of Community receipts, specifically in respect of Article 15 grants.

We need to sort out the way in which Article 15 receipts should be handled as soon as possible. As the paper makes clear, we cannot indefinitely hold up applications for Article 15 grants, not only given growing pressure from local authorities and members of Parliament, but also because of the risk that continued delay may affect our ability to draw fully on European Regional Development Fund funding as a whole.

The paper is long since it has been necessary to explore an extensive range of options. Of the five considered, only two seem workable in present circumstances, and I agree with officials that it is between these alternatives that we should chose. They are:

i) to make offsetting changes to central Government programmes in order to reflect Article 15 receipts;

ii) to disregard the receipts on a de minimis basis.

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As you will expect, I very much prefer the first of these alternatives. Our general policy on Community receipts is to handle them in such a way as to prevent increases in domestic public expenditure wherever possible. This is particularly important at a time when the Commission has pretensions greatly to expand the Structural Funds: if we do not maintain proper control now, especially in the area of local government expenditure, then we run the risk of allowing the Commission an ever-increasing say in the setting of our priorities and even the level of UK public expenditure. This is something which we must clearly avoid. The natural way of doing so is that set out in option 2 i.e. that the level of planned expenditure of relevant Departments should be reduced in the Public Expenditure Survey by an amount corresponding to Article 15 grants.

I note that your own officials opposed this option on the grounds that such a mechanism could result in consequent reductions of expenditure programmes to which Departments attach greater significance: however failure to make any offsetting savings would simply pre-empt public expenditure within planned totals from areas quite unrelated to the Article 15 grants themselves. So the preferred option is intended to tie the expenditure consequences of Article 15 grants as tightly as possible to analogous national activities. Where there are difficulties in finding activities comparable to those covered by individual Article 15 grants, I would be prepared to discuss where savings should be made on a case by case basis. I appreciate that the finding of appropriate offsetting savings may not always be easy: but this arrangement is by far the most effective means of ensuring that our agreed policy on Community receipts is respected, and it is therefore the one which I propose to adopt.

I note your officials' preference for the alternative which would simply disregard Article 15 receipts on the basis that the sums involved are relatively small. This seems to risk setting a dangerous precedent. Admittedly the numbers are not large at the moment, but as we have found with the European Social Fund, in Community matters small beginnings tend to lead to very large programmes later on. The Department of Environment estimate that notwithstanding the low level of anticipated receipts at the moment, Article 15 receipts might rise to between £5 million and £10 million between 1989 and 1990. This seems on the face of it to be a low estimate, particularly since in theory receipts in 1986 could have been as high as £30 million. I could not agree simply to ignore such sums on the grounds that they were "de minimis": clearly they may not be. If we got the handling of the question wrong now, then we would open the way to all sorts of exemptions later which, when added together, would lead to a very large loophole in effective public expenditure control. Naturally I could not accept that.

I therefore hope you will agree that we should maintain proper expenditure control in regard to Article 15 receipts by requiring Departments to make appropriate offsetting savings.

Given the length of time which it has taken to consider this, I should like to establish our policy by correspondence as soon as possible. However I would, if necessary, be prepared to chair a small ad hoc meeting of the Ministers concerned. I trust it will not prove necessary to take the matter to E(A).

I am copying this letter to the Prime Minister, David Young, Peter Walker, Malcolm Rifkind, Tom King, Norman Fowler, Geoffrey Howe and to Sir Robert Armstrong.

Yours sincerely

Malcolm Rifkind

JOHN MAJOR

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

CONFIDENTIAL

GRANTS FROM THE EUROPEAN COMMUNITY IN RESPECT OF CURRENT EXPENDITURE BY LOCAL AUTHORITIES

Note by Officials

INTRODUCTION

This note, which has been prepared by officials from HM Treasury, the Departments of the Environment, Employment, Trade and Industry, and the Scottish and Welsh Offices, considers how the Government's policy on the public expenditure treatment of European Community (EC) receipts should be applied in respect of grants from the EC which help finance current expenditure by local authorities. Such grants can be made from the European Regional Development Fund (ERDF), under Article 15 of the new ERDF regulation 1787/84 (copy attached at Annex A). An early decision on the treatment of such grants is needed so that applications can be forwarded to the European Commission: there is growing pressure from potential applicants for this to be done. The situation does not apply in Northern Ireland where there is no local authority expenditure of a relevant type.

THE GOVERNMENT'S POLICY ON COMMUNITY RECEIPTS

2. The Government's general policy on receipts from the Community Budget has two principal objectives:

(a) maximising the UK share of receipts without compromising our posture on budget discipline and the control of Community expenditure;

(b) using the receipts, as far as possible, to finance the Government's planned programmes of public expenditure (which are set at levels which reflect the existence of these receipts) rather than as additions to programmes.

This paper considers the options available for achieving these objectives in the case of local authority current expenditure.

3. In accordance with the Government's policy at 2(b) above, public expenditure programmes are set at levels that take account of the expectation of Community receipts. If receipts then become available for purposes other than financing the planned public expenditure programmes, then possible approaches include:

i) to reject or forgo the receipts;

ii) to accept them on the basis that sponsor departments would find savings to offset the extra expenditure which they finance;

iii) in cases where the Government does not receive the Community money directly but provides the recipient body itself with part or all of its funding (eg local authorities), to accept the receipts whilst making offsetting adjustments in that funding.

4. Local authority receipts from the Community budget for current expenditure may, in the absence of countervailing action, lead to increased spending by local authorities since the Government has less control over local authority spending than its own spending. In the past such receipts have been almost entirely limited to receipts from the European Social Fund (ESF). The Government's policy has been to pass these receipts on to local authorities subject to an undertaking that they will be used to increase balances or relieve rates and not to finance additional public expenditure.

ARTICLE 15 GRANTS

5. Article 15 of the ERDF Regulation 1787/84 provides for grants to promote 'greater exploitation of the potential for internally generated development of regions...' primarily by assisting small and medium sized firms to start up or expand their activities, and to obtain access to capital markets, new technology, advice on management and organisational matters etc. It is also intended to encourage the promotion and management of tourism and

accommodation. These objectives accord well with current UK policies.

6. The Regulation provides that payments under Article 15 may not exceed 10 per cent of a member state's ERDF minimum quota share. In the UK's case, this would have implied a limit of £30 million in 1986. In practice, the Department of the Environment estimates that receipts in 1986/87 were about £0.12 million and are likely to rise to £5-10 million by 1989/90.

7. While discussion has been continuing on possible ways of treating Article 15 receipts, the Department of Trade and Industry has been obliged to put a moratorium on forwarding applications specifically related to Article 15 to the Commission. This policy is now provoking increasing complaints from members of Parliament and from the local authorities, of whom many have excellent contacts in Brussels and have lost no opportunity to blame the Government for the delay.

8. There are more general reasons why increasing difficulties are expected from a continued moratorium on grant applications for Article 15 activities. The Commission is hardening its attitude on the distribution of ERDF funds by laying increasing stress on the submission of programme rather than project applications. It has also made it clear that it expects these programmes (such as National Programmes of Community Interest (NPCIs), in which a block grant is awarded for both capital and revenue purposes, to be disbursed by the member state in accordance with the objectives of the programme) to include grant related expenditure on Article 15 activities. Five of the six NPCIs approved for the UK have included an Article 15 element, although in only one case (Shildon) has money so far been passed to the local authority. This was done on the understanding that the public expenditure treatment finally agreed for Article 15 receipts should also be applied retrospectively in that case.

OPTIONS

9. Officials originally identified five ways of dealing with Article 15 receipts. Departments' views on them are set out below.

Option 1 - forward no applications for Article 15 receipts

10. Under this option, the UK would refuse to transmit to the Commission applications for Article 15 grants from local authorities. This would guarantee that public expenditure arising from such applications would not increase. Under this option, the UK would refuse to transmit to the Commission applications for Article 15 grants form local authorities. This would guarantee that public expenditure arising from such applications would not increase. However, the Commission has made it clear that failure to reflect Article 15 projects in UK programmes (namely ERDF NPCIs and Integrated Operations Programmes (IOs) - which combine funding from a number of Community instruments, including the ERDF) will jeopardise the chances of such programmes securing Commission approval. Given the increasing emphasis on programmes - which under the Commission's structural fund review proposals would become the predominant form of assistance - this could seriously affect the UK's ability to draw fully on ERDF funding. Although the Article 15 sums in such cases are small, the overall funding involved is substantial, and a number of programme submissions over the next 12 months could be affected (eg steel closure integrated operations). For this reason, as well as the problems of relations with the local authorities, the danger of well-publicised criticism (however misguided) of the Government's general policy on Community receipts and possible legal difficulties, it would in the view of officials be difficult to justify or sustain a policy of not forwarding <u>any</u> Article 15 applications.

Option 2 - make offsetting changes to central Government programmes

11. Depending on the nature or location of the particular project, the Department(s) concerned would make an estimate of expected ERDF Article 15 grants. In the Public Expenditure Survey there would be a corresponding reduction in the level of planned expenditure by the Department(s). Wherever possible this should

be concentrated on activities analogous to those covered in the project. The particular programmes concerned would need to be identified on a case-by-case basis, depending on the ERDF project concerned, in discussions between the relevant Departments and the Treasury. In accordance with the normal operation of the policy, if receipts exceeded the level allowed for in the public expenditure plans, the Department(s) concerned would be expected to provide offsetting savings.

12. A variant on this approach would be to bring Article 15 receipts within the EUROPES system. Under EUROPES, Departments must find offsetting savings to compensate for the net cost of certain EC programmes or put in additional bids in the following UK financial year (eg any overspends in 1988 will be taken into account in the PES round for 1989/90). The system applies in general to areas where UK receipts are mainly in the private sector - principally R&D. It does not currently apply to any ERDF receipts. In the view of officials, extension of EUROPES to embrace the structural funds as a whole is something that could be considered, but the details would take some time to work out and it is suggested that any consideration of this is best left until more experience has been gained of the current EUROPES arrangements.

13. The Treasury considers that the arrangements proposed in paragraph 11 are by far the most effective method of ensuring that the Government's agreed policy on Community receipts is respected, as the offsetting savings would fall on expenditure programmes over which the Government has direct control. Because there would be no direct reduction in grant recipients' funds from the Government, it would not attract adverse notice from the Commission.

14. Other Departments consider that they would not on the whole have associated programme expenditure against which to offset EC receipts, and that the consequence of this approach would therefore be that cuts would have to fall on other departmental

expenditures unrelated to local authority spending. The allocation of money to local government by the EC would result in offsets in expenditure programmes to which Departments attach greater significance. Hence spending priorities would no longer necessarily be determined by Departments but would be affected by EC decisions. Departments further noted that this option would not operate directly on the programme of local authority current expenditure concerned, so that there would be an impetus for the quantum of local authority current expenditure to increase.

Option 3 - pass grants to local authorities in return for undertaking that they will be used to reduce rates, not finance extra spending

15. This is the policy applied at present to grants to local authorities under the European Social Fund (ESF). It is difficult to police or enforce. These difficulties were recognised, but accepted on de minimis grounds, when the policy was introduced because of the low level of such receipts at that stage.

16. The Treasury's view is that this is the least reliable of the techniques used to give effect to the Government's policy on Community receipts and would therefore be an unfortunate precedent on which to build for Article 15 receipts. Although Article 15 receipts totalled only £0.12 million in 1986/87 (because of the moratorium on applications), they are expected to reach £5-10 million a year by 1989/90 on present policy (and might be higher if the Commission is successful in its attempts significantly to expand the structural funds). Extension of the existing policy on ESF receipts would also increase the pressure to disregard other receipts from the EC on de minimis grounds, and the cumulative effect of such concessions could be a significant increase in public expenditure.

17. Other Departments accept that this option lacks a formal control mechanism and cannot therefore be properly policed. They are also concerned that the attempt to impose it, even nominally, could be deemed to be inconsistent with the joint declaration of the Council and Commission in 1984 that ERDF receipts would

be, in general, an additional source of finance in the areas concerned.

18. In view of the problems outlined above with the current arrangements for local authority receipts from the ESF, Ministers may wish in due course to consider whether those arrangements should be changed - especially if they decide on a different system for Article 15 receipts. Officials recommend, however, that priority be given to reaching a decision in the first instance on the treatment of Article 15 receipts, for which no arrangements at all are in place.

Option 4 - Commensurate reductions in Aggregate Exchequer Grant to local authorities

19. Officials have also explored the possibility of reducing Aggregate Exchequer Grant (AEG) so as to offset expected Community receipts. On this approach, policy on grants in support of current spending would be broadly similar to that already operated on grants in support of capital spending (under which the borrowing permission given to local authorities is reduced by the amount of ERDF receipts received; so the receipts substitute for borrowing within the agreed capital spending limit, and do not fund additional projects).

20. The Law Officers advised towards the end of last year that ERDF (and ESF) receipts could not be regarded under local government legislation as 'moneys provided by Parliament' and therefore treated as a specific grant within the total of AEG determined by Ministers. Pending further instructions, they left open the question of whether such receipts could nevertheless be taken into account in determining the total of AEG. Following Ministerial correspondence earlier this year, extensive effort was put into the preparation of a further case to the Law Officers on this point. In the course of this, however, it has become clear that there would be a considerable risk of legal challenge to a declared policy of taking EC receipts into account in determining AEG, whatever the Law Officers might advise as to the likely outcome of the case. Such a challenge would be embarrassing to the Government, and might well encourage similar challenges in other areas of the Government's policy on Community receipts.

21. A further point is that reductions in AEG may in any case not lead to equal reductions in expenditure. Local Authority spending relevant for the calculation of AEG already excludes spending financed by EC receipts. If Ministers decide to determine AEG in any year as a percentage of relevant expenditure, and to the extent that EC-financed spending is not additional to other LA expenditure, AEG is therefore anyway reduced because of EC receipts. DOE consider that AEG is thereby reduced by about 46% of EC receipts for 1988-89.

22. In view of the points above, in particular the risk of a legal challenge, officials recommend that this option should not be pursued, for the time being at least.

Option 5 - Explicitly disregard Article 15 receipts on a 'de minimis' basis

23. The Treasury regard this option as unsatisfactory for similar reasons to Option 3: ultimately it may lead to an increase in public expenditure; would be inconsistent with the Government's wider policy on Community receipts generally; and could also set an undesirable precedent.

24. Other departments see this option as preferable to Option 2 on the grounds that it would avoid the objections referred to in paragraph 14. Such an option would, they argue, accept the practical outcome of the policy without running the risk of attracting unfavourable attention from the Commission. They argue that there is a finite limit to the level of receipts involved, so that this would not be an open-ended concession; and that the sums involved are insignificant when measured against total local authority current expenditure (the planned total for which in 1987/88 is nearly £30 billion). The Department of Environment also maintains that Article 15 receipts may to some extent be offset by the way in which the level of AEG is set (see paragraph 21 above).

CONCLUSION

25. Officials considered five possible methods for the handling of grants under Article 15 of the ERDF. Three of these were judged impractical. They were:

- Option 1 (paragraph 10) - forward no applications for Article 15 receipts;
- Option 3 (paragraphs 15-18) - seek undertakings from local authorities that grants will be used to reduce rates, not finance extra spending;
- Option 4 (paragraphs 19-20) - make commensurate reductions in AEG.

Should Ministers agree that these options should not be considered further for the time being, they are invited to consider which of the following two procedures should be applied to Article 15 grants;

- Option 2 (paragraphs 11-14) - make offsetting changes to control Government programmes; or
- Option 5 (paragraphs 21-22) - explicitly disregard these receipts on a de minimis basis.

CONFIDENTIAL

ABG

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref: 16pm

Jill Rutter
Private Secretary to
The Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

10 August 1987

Dear Jill,

A PRUDENTIAL REGIME FOR LOCAL AUTHORITIES

FLAP P. 32

My Secretary of State wrote to the Chief Secretary on 26 June covering the interim report of the Working Group on Local Authority Financial Prudence, and he replied on 20 July.

AT BACK OF FILE.

I now enclose a copy of the Working Group's further report. Section 1 provides a summary. The report sets out a detailed analysis of the principal creative accounting devices employed by local authorities, and of the financial position of the 20 authorities which appear to have become most heavily embroiled in creative accounting. It also provides an up-to-date report on the development of the prudential regime, and indicates the direction which the Group believes further work should take.

The Group's work is relevant to the forthcoming discussion of our proposals for a "stop" power for the auditor, which the Lord President suggested in his letter of 23 July. It also relates to the proposal for "overseers" on which my Secretary of State is due to report to MISC 109.

I am copying this letter and enclosure to David Norgrove at No 10, Mike Eland in the Lord President's office, the private secretaries to other members of MISC 109 and E(LF), and Trevor Woolley in Sir Robert Armstrong's office.

Yours,

Robin.

R U YOUNG
Private Secretary

100% RECYCLED PAPER

LOCAL GOVT

RELATIONS

PT 37

cc BG

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Tel: 01-233 3000 (Switchboard)
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270 0559
From The Minister of State

CT/6110/87

7 August 1987

CONFIDENTIAL

wbpm

Dear Nicholas,

A 'STOP' POWER FOR THE DISTRICT AUDITOR

AT FLAP PT32

WILL REQUEST IF REQUIRED

In the absence of Peter Walker I am responding to your correspondence with Willie Whitelaw. Your letter of 17 July proposed two measures to extend auditors' powers. Willie Whitelaw's letter of 23 July, commenting on your suggestions, said he was content with the first proposal but felt that the second needed more detailed consideration.

I am sure Willie is right. We shall shortly have the full report of the Working Group, promised in your letter of 26 June. This should allow us to consider a comprehensive package of measures, including possible clarification of local authorities fiduciary duty to balance the interests of current and future ratepayers among other considerations. Only then can we decide the best way to progress. In doing so we shall also have to pay regard to the interest of the great majority of local authorities who behave responsibly.

I am copying this letter to the Prime Minister, members of MISC 109 and E(LA), the Attorney General, First Parliamentary Counsel and Sir Robert Armstrong.

Yours ever

Wyn

WYN ROBERTS

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

LOCAL GOVT : Relation PT33

cc BG.

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

Our Ref : C/PSO/7797/87

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

06 AUG 1987

Dear Nicky.

PASSENGER TRANSPORT AUTHORITIES UNDER THE NEW LOCAL GOVERNMENT FINANCE REGIME

Thank you for your letter of 30 July. You will also have seen those of Douglas Hurd and John Major.

I am sorry that your view on this question does not coincide with my own and that of John Major. Clearly this is a scenario where our respective policy responsibilities - mine for the Passenger Transport bodies and yours for local government generally - overlap. I think, however, that the position expressed in your letter may have been based on a misunderstanding of what I was intending to achieve and I hope that, on reflection, you will feel able to agree my proposal.

I agree with you entirely that one of our prime objectives should be to increase the accountability of local government to the electorate so that they can in turn exercise a restraining influence on local authority expenditure. Indeed, my proposal is intended to increase accountability for public transport expenditure, not diminish it. As John Major has noted, my proposal is an improvement on the present system of precepting because it strengthens the link between expenditure and the ballot box. The essential point is that the PTAs are not directly elected local authorities and we cannot therefore secure accountability by treating them as if they were. Local electors can only exert any influence over the expenditure of their PTA through the constituent districts which appoint PTA members. It is therefore of the utmost importance that the local voter holds his district council responsible for the policies of the PTA because that is the only way in which PTAs are accountable. The draw-back of the present precepting arrangement is that it enhances the PTAs independence and allows the constituent district councils to distance themselves from PTA expenditure for which, by collective decision, they are responsible.

My proposal will not make the PTAs directly accountable to the local voters. I do not think that any of us wish to go that route. What it will do is strengthen the link in the voter's mind between his local council and his PTA's expenditure. There is, as you point out, the possibility that a low spending district which is in the minority on a PTA will appear responsible for high spending PTA policies which it was unable to prevent. But the district is not entirely powerless in this situation. As you will recall, section 42 of the Local Government Act 1985 contains power for district councils to secede from PTAs. One of the merits of my proposal is that in such situations, districts will be forced to consider the possibility of secession, rather than simply washing their hands of PTA expenditure which their electors have to fund. If anything, this represents a gain in accountability.

My proposal does, of course, have the other advantages in respect of GREs which I pointed out in my previous letter. I was interested from his letter to me of 28 July, that Douglas Hurd has experienced similar difficulties.

I hope therefore that you will, on reflection, agree that my proposal merits further consideration. Clearly, it would have been desirable for colleagues on E(LF) to have considered the matter when I first wrote, though it was perhaps inevitable that other, more pressing considerations, would have to take precedence. I suggest, therefore, that officials from interested Departments should urgently consider my proposal and report back to us as soon as possible. (They will also need to look at the question of the public transport GREs, such as the future of local rail support, to which the enclosure to my last letter alluded.)

Copies of this letter go to the Prime Minister, other members of E(LF) and to Sir Robert Armstrong.

Yours,

PAUL CHANNON

Paul

Local Gov't: Rels PT32

DCACCS
cBG.

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

6 August 1987

CONSULTATIONS WITH LOCAL GOVERNMENT

The Prime Minister has seen your Secretary of State's letter of 4 August to Kenneth Baker. She takes paragraph 3 to mean that the opening of private discussions with small groups of local government representatives will be on an experimental basis only. The Prime Minister's own view is that this approach will not prove to be the right way forward. I think it would be helpful if you would arrange for her to have an assessment of the experiment before any steps are taken to put the proposals onto a more permanent footing.

I am copying this letter to the Private Secretaries to the Lord President, the Home Secretary, the Secretaries of State for Employment, Social Services and Transport, the Chancellor of the Duchy of Lancaster, the Chief Secretary, the Minister for the Arts and to Sir Robert Armstrong.

(M.E. ADDISON)

GA

Robin Young, Esq.,
Department of the Environment.

CONFIDENTIAL

FLE
DAS
BG

SUBJECT
CC MASTER

10 DOWNING STREET

LONDON SW1A 2AA

From the Principal Private Secretary

6 August 1987

Dear Alan,

THE NEW PLANNING TOTAL

The Prime Minister had a brief discussion with the Chancellor of the Exchequer this morning about your letter of 5 August concerning proposals for a new planning total.

The Prime Minister said that, in the light of the arguments in the note attached to your letter, she was now more convincned by the merits of the proposal set out in the Chancellor of the Exchequer's minute of 30 July. She agreed that the Chancellor of the Exchequer could discuss the proposal with the Secretary of State for the Environment on a strictly confidential basis and that Treasury officials should talk on a similar basis to two or three key officials in DoE. The Chancellor of the Exchequer should then report the outcome of those discussions to her with advice on how to carry the matter forward. Meanwhile, she had not taken a final decision, one way or another, on the proposal.

Yours sincerely,

Nigel Wicks

N L WICKS

A. C. S. Allan, Esq.
H. M. Treasury

CONFIDENTIAL

PRIME MINISTER

The Chancellor would like authority for him to speak to Mr. Ridley and for Treasury officials to talk to two or three key DOE officials about his proposal for a new planning total which excludes local authority spending but includes Central Government grants to local authorities. Can you agree, provided it is done in the strictest confidence?

(Incidentally, I shared many of your reservations about this proposal but 20 minutes conversation with Andrew Turnbull, who with Robin Butler is one of the authors of the concept, has made me see the proposal in a more favourable light. Andrew's main arguments why the proposal does not represent a relaxation in public expenditure control are set out in the note attached to the Treasury letter.)

N.L.W.

NIGEL WICKS

5 August 1987

VC3ARI

LP.C13/011

CONFIDENTIAL

NW.

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

Prime Minister

David Norgrove Esq
10 Downing Street
LONDON SW1

5 August 1987

Dear David,

A NEW PLANNING TOTAL

In your letter of 31 July you recorded that the Prime Minister was concerned that the proposals for a new planning total might ease central government pressures on local authority spending, or might give that impression. The Chancellor is conscious of this danger. But he sees the proposals, not as relaxing pressure on local authorities, but as complementing and reinforcing the increased pressures which the reforms of local government finance are intended to bring. The Prime Minister may find it helpful to see the attached note which expands the arguments.

The Chancellor welcomes the opportunity to discuss the proposals with the Prime Minister in September. Your letter said that, in the meantime, knowledge of it should not go outside the Treasury. The Chancellor would, however, find it helpful if, before the meeting, he was able to have a reaction from Mr Ridley. I would therefore be grateful if you could establish whether the Prime Minister would be content for the proposals to be shown to Mr Ridley on a strictly confidential basis, with Treasury officials to talk on a similar basis to two or three key officials in DOE.

Yours
Alex

A C S ALLAN
Principal Private Secretary

NEW PLANNING TOTAL: ARE WE QUITTING ON CONTROLLING LOCAL AUTHORITY EXPENDITURE, OR APPEARING TO DO SO?

Points to make

(i) Not quitting on local government expenditure. Government policy expressed in terms of general government expenditure, which includes local authority expenditure. So we care about limiting as much as ever.

(ii) Present arrangements not effective. Grant is our most important instrument in restraining local authorities. At present grant as such is not included in the planning total. So increasing it appears painless. Argument is conducted in terms of financing a set proportion of whatever local authorities decide to spend. Cedes initiative to them.

(iii) Reform of local government finance will provide greater central government influence over local authorities' income from non-domestic rates and will increase pressure of accountability on community charge. New planning total would complement this by putting the spotlight on grant. Thus pressures on all three sources of local authority current income would be intensified.

(iv) Reform of local government finance intended to clarify distinction between central and local government responsibility. New planning total would do precisely that. If forward plans for grant are set out as part of the planning total local authorities will find it harder to blame increases in community charge on changes in grant.

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

The Rt Hon Kenneth Baker MP
Secretary of State
Department of Education and Science
Elizabeth House
York Road
LONDON
SE1 7PH

4 August 1987

Dear Kenneth

CONSULTATIONS WITH LOCAL GOVERNMENT

You were present at the meeting of the Consultative Council on Local Government Finance (CCLGF) on 13 July when there was some discussion, at the Associations' initiative, of the scope for more fruitful meetings between local authority representatives and Ministers to discuss various broad issues to do with the role of local government and its relationship to central government.

I have been considering how to carry this forward. CCLGF is much too large and cumbersome for the effective exchange of views between Ministers and councillors. It is in any case an appropriate body only for general issues of local government finance. There may therefore be a role for smaller and more private meetings to discuss the broad issues that go beyond finance and more particular topics and subject areas. I am by no means convinced that such meetings will be useful - they could easily become another forum for scoring political points and airing familiar arguments - but in view of the evident desire on the part of some local authority representatives to find a more co-operative approach, and the silence of others who might have been expected to object, I am prepared to give it a try.

I have therefore written to Councillor Allison, Chairman of the Association of County Councils, as attached, expressing my willingness to have private and confidential discussions with a small group of local government representatives. If they respond positively I would propose to have a first discussion in the autumn, of a rather general kind. Other, more specific issues can follow later if the first occasion suggests that would be useful.

There will be occasions, if this comes to anything, when it would be sensible for individual colleagues to join in for a particular discussion, but I am sure it would give quite the wrong flavour if there was widespread Ministerial attendance as a matter of course and I would not propose to trouble colleagues with the first meeting.

100% RECYCLED PAPER

Copies of this letter go to the Prime Minister, the Lord President, the Home Secretary, the Secretaries of State for Employment, Social Services and Transport, the Chancellor of the Duchy of Lancaster, the Chief Secretary, the Minister for the Arts and to Sir Robert Armstrong.

NICHOLAS RIDLEY

This is 100% recycled paper

PART 32 ends:-

DRN TO PM 30.7.87

PART 33 begins:-

SS1D06 SS1D6S 4.8.87

~~HMT~~ TO ~~DRN~~ ~~F.V.V~~

CONFIDENTIAL

A PRUDENTIAL REGIME FOR LOCAL AUTHORITIES

FURTHER REPORT BY

THE WORKING GROUP ON LOCAL AUTHORITY FINANCIAL PRUDENCE

August 1987

CONFIDENTIAL

A PRUDENTIAL REGIME FOR LOCAL AUTHORITIES

FURTHER REPORT BY

THE WORKING GROUP ON LOCAL AUTHORITY FINANCIAL PRUDENCE

AUGUST 1987

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1. INTRODUCTION TO THE REPORT

1.1. BACKGROUND

1.1.1. The Working Group on Local Authority Financial Prudence was set up to examine the use of creative accounting devices by local authorities, and to review the various measures being developed to encourage prudent financial behaviour in local government. It is chaired by DOE and has represented on it the Treasury, the Scottish and Welsh Offices, the Bank of England, the Audit Commission and the No. 10 Policy Unit.

1.1.2 The interim report of the Working Group, circulated under cover of the Secretary of State for the Environment's letter of 26 June to the Chief Secretary, described progress with current work and the timetable for the future. The contents of this further report are summarised below.

1.2. SUMMARY OF THE REPORT

Section 2

1.2.1. A number of distinct "creative accounting" devices can be identified, and a distinction drawn between "creative accounting" and "creative financing". The former is the exploitation of accounting practices to gain financial advantage, the latter the use of means of raising finance which are generally forms of pseudo - borrowing. Both erode Government expenditure controls; the latter also undermines authorities' creditworthiness, if used to excess. The report sets out the nature and where known the scale of each device; these are listed in paragraph 2.1.1, and include the use of special funds, deferred purchase, advance leasing, lease/leaseback, and others. Where appropriate, the report describes the Government counter-measures taken. However, local authorities and the City have continued to identify new devices as the old ones are blocked off, and there is an evident need to move

away from piecemeal action on individual devices as they come to light, towards a more general solution to the underlying problem of creative accounting This section of the report also describes the aggregate effects of creative accounting, and notes the importance of keeping up to date with new devices as they become available. Authorities will probably be incurring substantial costs by 1990/91 as a result of arrangements already entered into, but it is thought that they have considerable scope for re-financing.

Section 3

1.2.2. Examination of the available information about the 20 authorities which have indulged to the greatest extent in "creative accounting"suggests that these authorities should get through 1987/88 without breakdown. There is however some uncertainty, in particular about Haringey. It is too early to be confident about the position in 1988/89. Many of the authorities face large "funding gaps", which together total some £982m. They may negotiate creative accounting deals to cover these, but (possibly in response to Mr Ridley's statement on local authority debt) the City appears to be becoming more wary of financing authorities in apparent difficulties. The alternative, if financial collapse is to be avoided, is the adoption of measures to secure substantial savings in the short term.

1.2.3. Recent statements by the Association of London Authorities have suggested a new realism in facing financial problems, and some options for greater economy and efficiency can be identified. These, although they do not provide a complete solution, could enable the authorities concerned to reduce their net expenditure considerably. If the will is there the authorities may thus be able to take steps to improve their position in 1988/89, but the scale of their difficulties should not be underestimated. Even if the flow of new creative accounting is slowing down, the worst affected authorities already have significant deferred liabilities to cope with in 1989/90 and beyond.

1.2.4. A critical element will be the rate increases levied by non-rate-capped authorities (which include some of those previously rate-capped with the most substantial "gaps" such as Islington, Brent and Sheffield) and the extent to which the rate limits set by the Secretary of State make an allowance for "funding gaps". There is, however, a need to get better information on financing deals entered into by individual authorities and their future costs, as well as general information about the types of deal available (referred to in paragraph 1.2.1 above).

Monitoring

1.2.5 Both sections 2 and 3 of the report draw heavily on the work of the Working Group's monitoring sub-group (on which the PWLB is also represented). It is intended that this sub-group should remain in being and continue to act as a forum for the exchange of information about developments in creative accounting and creative financing, both in general and as they affect the position of individual authorities. Profiles of the kind shown at Annex A to the report are available for the 20 authorities thought to be most heavily engaged in creative accounting, and will be maintained and updated on a regular basis.

Section 4

1.2.6. If a more comprehensive solution to the problem of creative accounting can be found, it is likely to lie in a package of inter-related measures which, supporting the forthcoming reforms of local government finance and the capital control system, will together act to encourage financial prudence amongst that minority of local authorities who at present neglect it. This package would comprise what has been called the "prudential regime", and would ideally permit a graduated response by Government to authorities behaving imprudently. This would involve the tightening of the screws on an authority as it moves further into the area of imprudence -from signals to lenders that an authority is an increasing risk; through restraints, or in the end prohibitions, on action by the authority; to direct intervention by Government in the form of appointing overseers or Commissioners. However, much work remains to be done before we can be sure that an effective regime of this kind can be put in place. This section of the report describes progress in developing the component elements of the prudential regime, which are listed in paragraph 4.1.5. It also comments on the likely impact on local authorities of the proposed regime, and their probable reaction to it.

1.2.7. On the elements of the regime the findings and recommendations of the Working Group can be summarised as follows:

i. Definition of borrowing: it will be very important to continue to develop a definition which encompasses 'pseudo-borrowing' (deferred purchase, lease/leaseback) and brings it within the capital control system. The Group recommends that work should continueon a statutory definition of borrowing, for inclusion in legislation on the capital control system in 1988/89 (para 4.2.10).

ii. Prudential ratios are worth pursuing as an element in the new regime to provide signals to lenders and a framework for other elements of the regime. A good deal of further work needs to be done before it is clear that acceptable and workable ratios can be identified. The Group recommends that this work, which is principally for the Audit Commission, should be progressed urgently. Considered proposals should be available in October (para 4.3.10).

iii. The auditor's stop power will be a useful component of the overall prudential package, enabling the auditor to prevent unlawful acts and, if the proposed new statutory definition of local authorities' fiduciary duty is accepted, highly imprudent ones also. The Group notes that it is intended to legislate on the first element of this proposal (and the second also, if Ministers agree that this should be proceeded with) in the Local Government Bill (para 4.4.5).

iv. Role of the Treasurer: Giving the local authority Treasurer a strengthened role in relation to the legality and propriety of his authority's expenditure will also play a useful part in the prudential regime, especially in conjunction with the proposed stop power. The Group notes that it is proposed, subject to Ministerial agreements, to legislate in the Local Government Finance Bill (para 4.5.2.)

v. Exchequer Grant: Under present legislation, central Government would only be able to withdraw mandatory grants such as RSG if an authority was acting illegally. The Group recommends that no new powers should be taken to allow Ministers to withhold grant where they considered an authority was financially imprudent (para 4.6.7).

vi. Good practice certificates are concerned more with the financial management systems needed for prudent management with than imprudence directly. The Group recommends that they should be developed separately by the Audit Commission in due course and not considered as part of the prudential regime (para 4.7.5).

vii. The proposal for the appointment by the Secretary of State of Overseers for authorities in financial difficulties has merit but needs further working up, together with an associated proposal by which authorities would themselves appoint consultants to assist in the

formulation and/or monitoring of a recovery plan. The Group recommends that a detailed paper exploring the options, and taking account of the question of the standard of service provision embodied in a recovery plan, should be put to Ministers in September (para. 4.8.5).

viii. Role of the PWLB: The charging by the PWLB of differential interest rates would be desirable, but the viability of such a scheme depends on success in developing prudential ratios which can provide a satisfactory test of creditworthiness, and would almost certainly require new legislation. The Group recommends that other options for regulating Government lending to authorities close to collapse should be worked up for its consideration.

1.2.8 Finally, sub-section 4.10 notes that some updating of the draft Commissioners legislation is being undertaken.

1.3. THE POSITION IN SCOTLAND AND WALES

1.3.1 This report is principally concerned with the consequences of action by a small number of English authorities. Creative accounting by Welsh or Scottish authorities is thought at present to be on a significantly lesser scale than that in England. However, a recent report by the Commission for Local Authority Accounts in Scotland says that Scottish authorities' accounts for the last two years show around 200 cases of questionable accounting practices (eg wrong classification of expenditure as between capital and current, apparently undertaken for the purposes of evading Government controls) but the amount of money involved totals around £55 million, or less than 1% of local authority current expenditure in the period. As regards the more novel creative financing devices which are a principal cause of concern in England, the only signs in Scotland are of a number of covenant schemes (a form of deferred purchase) to a total value of around £400 million; 26 authorities are known to have entered into such schemes. In some cases these have been entered into to facilitate lumpy investment programmes by small authorities, and are unexceptionable. Three authorities stand out -Edinburgh District which is known still to be active in investigating creative accounting options, Glasgow District which has borrowed £75 million for house improvements, and Lothian Region which has borrowed £45 million, originally for new road construction but now diverted to other purposes. Except possibly in the case of Edinburgh, which auditors are now examining, none of these schemes are thought to give rise to difficulties about future repayment. Moreover, the Secretary of State has now brought covenant schemes firmly within his capital control system. Nevertheless, there can be no guarantee that English practices will not prove contagious.

2. METHODS OF CREATIVE ACCOUNTING EMPLOYED BY LOCAL AUTHORITIES

2.1 INTRODUCTION

2.1.1 This section describes the principal creative accounting devices employed by local authorities, giving an assessment of the scale and nature of the problem and outlining the counter-measures already taken by central Government. The final paragraphs summarise the aggregate effects of "creative accounting" on both the capital and revenue sides. As will be clear from the text, "creative accounting" is a loose term which covers not only the exploitation of accounting practices to gain financial advantage (the use of special funds, capitalisation etc) but also creative financing, primarily of the "spend now, pay later" kind (deferred purchase, lease/leaseback etc)- effectively borrowing by another name. Both types are designed to circumvent Government expenditure controls; the latter also undermines authorities' creditworthiness. The text separately identifies accounting and financing devices.

2.1.2. The following devices are discussed:

Sub-section 2.2 Use of Special Funds
2.3 Capitalisation
2.4 Use of Superannuation Funds
2.5 Changed Sinking Fund Rate
2.6 Deferred Purchase
2.7 Sale/Leaseback and Lease/Leaseback
2.8 Sale of Mortgages
2.9 Advance Leasing
2.10 Diversification of Rented Housing
2.11 Interest Rate Swaps
2.12 Parallel Loans

2.1.3. The advent of the community charge and the new grant system will make redundant those devices which rely for their effect on the relationship of spending to grant, but it will not remove the desire by some authorities to

spend now and pay later. What follows is therefore of relevance both to the current and to the new systems of local government finance. This section of the report also indicates the piecemeal nature of the approach which Government has so far adopted, acting against individual devices - sale of mortgages, deferred purchase, leasing - as they become established, and the ingenuity of the City/Local Government in devising new ones. It this underlines the case for replacing this piecemeal approach by a general attack on the philosophy behind "creative accounting", and authorities' ability to indulge in it. It also makes it clear that the Government will continue to need to keep up with the development of new financing devices as they emerge.

2.2 USE OF SPECIAL FUNDS (ACCOUNTING)

The Methods Used

2.2.1 Contributions made by an authority to a special fund set up under Schedule 13 of the Local Government Act 1972 have been counted as "total" expenditure for the purpose of calculating block grant entitlements, whilst the spending of sums out of such funds has not. As block grant mechanisms became tougher each year local authorities began to make notional payments into special funds, in years when the grant penalties for extra expenditure were relatively mild, to draw down in later years to reduce expenditure and minimise grant losses. Some authorities have manipulated their balances to such an extent that notional contributions to special funds are sufficient to result in a deficit on the rate fund. This has become known as deficit financing of special funds.

2.2.2 Special funds have been drawn on by rate-limited authorities to enable spending in excess of their expenditure level. Capital funds, housing revenue account balances, trading services account balances and others have all been used for this purpose.

The Scale of the Problem

2.2.3 In order to avoid the increasing severity of the block grant regime from 1981-82 onwards local authorities made unallocated contributions into special funds of £1.5 bn in the years 1981-82 to 1984-85, which have been drawn down to the tune of £0.8 bn in 1985-86 and 1986-87 (see Table 1). The impact of changes in the marginal rates of block grant loss for increases in total expenditure

has thus been considerably mitigated. Nottinghamshire, for example, have gained £141m block grant by making net withdrawals of £46m from special funds over a period of five years (see Table 2).

2.2.4. In practice, many authorities have now exhausted their funds, though some £1bn of special funds still remain. The main concern now is that by drawing down their funds rate-capped authorities have been able to avoid the real cuts in spending which they were intended to have to make. As the scope for drawing down special funds decreases the authorities will have to make acute reductions in expenditure in future years, if they are not permitted to raise their rates to bridge the gap.

Counter-Actions Taken

2.2.5 The Local Government Finance Act 1987 put the established uses of special funds on a firm statutory basis. It did however also provide the means to outlaw deficit financing of special funds, through the making of specifications which would have the effect of excluding certain transfers from relevant and total expenditure, so preventing authorities from gaining any block grant advantage from this sort of transfer. The use of special funds as a device to maximise grant entitlements between years will end with the new system of local government finance to be introduced in 1990, when grant entitlement will be divorced from an authority's actual spending.

2.3. CAPITALISATION (ACCOUNTING)

The Method Used

2.3.1. There are a number of categories of expenditure which an authority has discretion to classify as either revenue or capital. The most significant of these is housing repairs and maintenance. This is traditionally a revenue item, but authorities can if they wish charge it to their capital account and finance it by borrowing, capital receipts or deferred purchase rather than by revenue. If it is financed by borrowing, it is prescribed expenditure and scores against the authority's capital spending limit, making it of less interest to many authorities as a creative accounting device. But if it is financed by capital receipts the expenditure is not prescribed, and by doing this an authority can use up receipts faster than would normally be allowed by the prescribed proportion rules, which limit the rate at which receipts may be used for

prescribed expenditure. Finally, if it is financed by a deferred purchase scheme it is again not prescribed and so is not affected by the new rules contained in the Local Government Act 1987 (see paragraph 2.6.5 below).

2.3.2. Some local authorities have been capitalising for several years as a means of increasing the overall level of repair and maintenance work, and in some cases the treatment of major repairs or renovation as a capital item is entirely justifiable. But increasingly authorities are using the device to reduce the level of revenue expenditure on repairs and thus the size of their rate fund contribution to the housing revenue account and in turn their total rate-borne expenditure. Some authorities have carried this to the point of entirely eliminating revenue expenditure on repairs and maintenance. The authority in the past gained both a block grant advantage from this arrangement and extra housing subsidy.

The Scale of the Problem

2.3.3. Table 3 shows examples of authorities where capitalised housing repairs are around £10m or above. The figures show that these authorities have capitalised about £89m more spending in 1986-87 than in 1985-86. It is thought that capitalisation deals account overall for a very large part of the creative accounting undertaken by local authorities.

Counter-Actions Taken

2.3.4. Ministers have tackled the implications of capitalisation for housing subsidy. Authorities benefitted because payments were previously based on notional levels of uncapitalised housing maintenance, which were not reduced if the authority had capitalised expenditure, plus actual levels of capital expenditure. In February 1987 a general determination was issued to the effect that entitlement to housing subsidy would be based on either actual revenue expenditure or the notional level, whichever was lower.

2.3.5 It might be possible to introduce legislation to tackle the capitalisation problem more fundamentally from 1988/89. However, the Government plans in any case to bring in legislation in 1988/89 to reform the capital control system, with effect from 1990/91. Although present work is focussing on borrowing controls and the concept of prescribed expenditure may therefore no longer be relevant, the opportunity could be taken then to tighten up the grey area of what is and is not capital, and for what purposes authorities may or may not borrow or use capital receipts.

2.4 USE OF SUPERANNUATION FUNDS (ACCOUNTING/FINANCING)

The Methods Used

2.4.1. The local government superannuation scheme (LGSS) is contained in detailed statutory regulations made by the Secretary of State under powers provided by the Superannuation Act 1972. There are 88 administering authorities in England and Wales (mainly County Councils and London Borough Councils) who are required by the regulations to establish and maintain superannuation funds. The market value of these funds is now estimated to be about £25bn. Of this, the funds of the 32 London Boroughs and the City are worth about £3bn in total.

2.4.2. An administering authority might use superannuation funds to evade expenditure controls. Employers' contributions might be suspended in anticipation of an actuary's favourable interim or regular revaluation of the fund. This results in immediate revenue savings, but possibly at the expense of increased expenditure in later years if it becomes necessary to replenish the superannuation fund from the rate fund. Another device centres on the use of funds. Under the present regulations up to 10% of the fund can be used by the administering authority or lent to other authorities, for purposes for which they have statutory borrowing powers. However, funds might also be invested in companies set up and controlled by the administering authority, which could by this route carry on activities outside of the normal constraints on expenditure provided that there was a reasonable expectation of a return on the superannuation fund's capital. (Although concern about superannuation funds has centred recently on the "News on Sunday" case, where a number of authorities put money (arguably for political reasons) into the newspaper which is now in receivership, these unsound investments cannot really be classed as creative accounting.)

The Scale of the Problem

2.4.3. It is not clear that use of superannuation funds yet represents a significant problem from the creative accounting perspective. However, a number of authorities including Liverpool and Lambeth have used a reduction in contributions to their funds to assist their financial position.

Counter-Actions Taken

2.4.4. The regulations governing the management of superannuation funds were significantly relaxed in 1983, to give administering authorities greater freedom in their investment decisions. Largely in response to the "News on Sunday" case DOE Ministers are currently considering the arguments for making further changes, for example in order to restrict the proportion of a company's unlisted share capital that can be held by local government superannuation funds, or to remove responsibility for the management of funds from London Boroughs. The Audit Commission's present view is that there is no power to make interim revaluations of a superannuation fund. This will constrict the scope for reducing or suspending employers' contributions.

2.4.5. The use of investment in companies controlled by the authority as a means of avoiding constraints on expenditure is being considered in the context of the review of capital controls. The question of local authorities' interest in companies is also being examined, in response to a recommendation of the Widdicombe report, by an interdepartmental study group on which consultants are represented, and which should report in November.

2.5. CHANGED SINKING FUND RATE (ACCOUNTING)

The Methods Used

2.5.1 Authorities have a degree of discretion as to the way in which they make provision in their accounts for meeting future loan charges. Some use a sinking fund. A number of local authorities have chosen tc increase their sinking fund rates, often from 5% to 10%. Repayments of principal are thereby lower in the early part of the loan. This has the effect of reducing revenue contributions in the short term, at the expense of higher costs over the loan as a whole, but did not in the past reduce entitlement to housing subsidy which was paid on the basis of a notional 5% sinking fund rate.

Counter-Actions Taken

2.5.2 The main constraint on this and other creative accounting for loan charges is that the auditor would object if manifestly inadequate provision were made. The housing subsidy anomaly has been partly removed by increasing the sinking fund rate on which entitlement is based to a notional 8% (or an actual lower rate if applicable).

2.6 DEFERRED PURCHASE (FINANCING)

2.6.1 A deferred purchase arrangement is one in which a financial institution agrees to finance capital work to be carried out for an authority now but does not require payment from the authority until a future year. The Government accepted the existence of such schemes for many years, because at that stage they were limited to relatively few authorities, usually small districts, which used the device to achieve a one-off capital project which was difficult to accommodate within their spending ceiling for a single year. During 1985 and 1986, however, a number of major authorities undertook such schemes on a large scale. In most cases they were used to avoid capital controls but some were undertaken as a way round rate limitation. By financing, or releasing other funds to finance, capitalisation (see sub-section 2.3 above) they helped authorities to spend up despite rate limits.

2.6.2. Conversely, during periods when revenue and capital control systems are becoming progressively tougher it may be attractive to an authority to incur expenditure in advance of its need for a particular project. An advance purchase deal involves payment to a financial institution covering work to be carried out in a future year. Although the nature of this device is such that it is less attractive to authorities when pressures on spending are severe, there have been occasions - notably before the reduction in prescribed proportions at the beginning of 1985-86 - when imminent capital control changes have led to a spate of such schemes.

The Scale of the Problem

2.6.3 Many authorities have entered into significant deferred purchase deals. Our evidence is probably incomplete. However, Table 4 lists 35 authorities (four of them in Scotland) who are known to have entered into deferred purchase schemes to arrange works to the value of £1.8 bn. The works will be carried out

over the next few years but the payments by the authorities will be spread over a much longer period. The total cost will eventually be much higher than £1.8bn because it will include substantial interest payments.

2.6.4 As an example, Sheffield City Council has entered into deferred purchase agreements worth £110m to cover projects to be undertaken in the financial years 1986/87 to 1988/89. Repayments do not begin until 1989/1990, with fairly short redemption periods ending in 1996/97. The initial annual repayments will be £20m/£25m. At present the Council enjoys the use of what is in effect borrowed money without suffering block grant penalties or incurring any costs to be met from the rate fund. In the 1990s, however, the cost to ratepayers of these arrangements would be the equivalent of at least 100p in the pound on local rates - and under the existing block grant regime would be several times higher, because of grant penalties.

Counter-Actions Taken

2.6.5 In view of the increasing use of these schemes, the Government announced last July that it would take powers to inhibit the use of advance and deferred purchase as a means of avoiding the Government's capital expenditure controls. The Local Government Act 1987 contains provisions to put this into effect. The timing of prescribed expenditure is now determined by reference to the year in which works are carried out by or for an authority, rather than the year in which the payments are made,thus making these schemes considerably less attractive to authorities. The legislation applies retrospectively to contracts and other arrangements to which authorities have become committed on or after 23 July 1986. Most of the deals listed in Table 4 were arranged before this date but there are indications that some authorities at least might not have been legally committed to the arrangements to a sufficient extent to escape the provisions of the 1987 Act.

2.6.6. Ministers have announced that there will be a de minimis general exemption to enable authorities, particularly the smaller ones, to spread the cost of an occasional one-off project which is large in relation to their annual spending ceiling. There will also be a specific exemption to enable authorities to continue carrying out their building and improvement under licence housing schemes. This exemption will be backdated to 23 July 1986, so as not to disadvantage authorities who may have continued to enter such schemes in good

faith on or after that date without realising the impact of the 1987 Act. Regulations are needed to bring the exemptions into force, and the local authority associations are now being consulted on these, with a view to introducing them on 1 September 1987.

2.7 SALE/LEASEBACK AND LEASE/LEASEBACK (FINANCING)

The Methods Used

2.7.1 The Government encourages local authorities to secure the genuine disposal of surplus assets, and to this end permits a proportion of the capital receipts generated to be invested in new capital expenditure. However, some authorities have increasingly looked for ways of generating capital receipts without effecting a true disposal.

2.7.2 A number of authorities have entered sale/leaseback or lease/leaseback agreements. These deals:

- consist of the freehold disposal of an asset followed by its immediate reacquisition by lease (sale-leaseback); or a leasehold disposal and reacquisition by lease (lease/leaseback);

- may involve land or buildings but not equipment (the new regulations bringing finance leasing within the control system - see paragraph 2.9.4 below - mean that the reacquisition of equipment would involve prescribed expenditure and so be unappealing to authorities);

- are on terms which provide for a substantial up-front premium for the disposal but annual rental payments for the reacquisition. They often include a holiday from rental payments in the early years of the scheme.

An authority therefore obtains a substantial lump sum which has to be repaid over a number of years - giving a short-term cash-flow advantage but adding to future commitments every bit as much as conventional borrowing. It can use the receipt for capital spending (subject to the prescribed proportion) or to relieve the revenue budget through capitalisation. But in most cases the main purpose of the deal is to earn interest on the capital receipt so as to help the revenue budget. Although sale/leaseback and lease/leaseback are themselves

perfectly acceptable financing techniques in the commercial world, their use by local authorities to gain short-term support for unrealistically high current expenditure, at the expense of substantial future liabilities, is a cause of concern.

The Scale of the Problem

2.7.3. The information available about the amounts involved in deals of this sort is probably incomplete. However, Table 4 lists 7 authorities who are between them known to have secured or to be considering leaseback deals to a value of £534m. There are indications that some of the authorities are having difficulty obtaining the necessary finance.

Counter-Actions Taken

2.7.4. The Government has made clear in answer to an inspired PQ and on several other occasions that it does not stand behind local authority debt and that debt arranged through unconventional financing deals is less secure than debt from conventional borrowing. This appears to have had some effect and to have contributed to the difficulty in securing deals mentioned above. In the long term a new system of controlling local authority borrowing for capital, which redefines borrowing to include these deals, offers the best solution to the problem.

2.8 SALE OF MORTGAGES (FINANCING)

The Methods Used

2.8.1. The sale of mortgage books has been a particularly attractive form of creative accounting. An authority would sell its mortgage book to a financial institution, sometimes without informing the mortgagors and sometimes retaining the risk attached to the mortgages. Such a transaction would provide the authority with immediate cash and capital spending power, although it would be deprived of regular payments in the future and might still have to meet loan charges on the mortgages for years to come. The capital spending power could be used to relieve the revenue budget by capitalisation.

Counter-Actions Taken

2.8.2 The Government acted in the Local Government Act 1986 to tighten up the rules relating to the sale of mortgages. Mortgagors must now always be informed of the sale in advance and give their consent: this will make it harder for authorities to rush through sales in order to generate cash. Moreover, unless the buyer takes all the risk attached to the mortgage as part of the sale, no capital receipt will be scored.

2.9 ADVANCE LEASING (FINANCING)

The Methods Used

2.9.1 Up to 1986/87 the finance leasing of vehicles, plant etc did not count as prescribed expenditure. Tax allowances were also available to lessors of capital assets. These incentives led to a rapid growth in leasing. Ministers decided that as this growth reduced the scope for adequate capital allocations, finance leasing should count as prescribed expenditure.

2.9.2. As authorities were aware of this change a large number of them entered into advance leasing deals, before 1 April 1987, for the acquisition of vehicles, plant etc. The deals involve an authority in acquiring assets over a number of years (anything from 2 to 10 years). However as the agreements they entered into gave them an interest in the future use of the asset at the date of the agreement the present rules allow an authority to score the capital value of the asset at that date. As this was before 1 April 1987 the acquisition of these assets did not count as prescribed expenditure.

The Scale of the Problem

2.9.3. Although we have no firm figures on the scale of advance leasing it appears that authorities have entered into advance leasing commitments, before 1 April 1987, amounting to well over £1 bn. However there is no way of saying whether all these arrangements will be used. There is some evidence that because of the interpretation by the Inland Revenue of the law relating to capital tax allowances many of these arrangements will not proceed.

Counter-Actions Taken

2.9.4. As the incentive to enter into advance leasing on a large scale to evade capital controls arose only once, there is no specific counter-action that could and need be taken. All finance leasing is now prescribed expenditure. However the total for capital allocations for 1988/89 and subsequent years will take account of the assets acquired during the relevant year under advance leasing schemes arranged in 1986/87. Ministers are also considering the possibility of taking into account the level of advance leasing undertaken by individual authorities when making allocations for those authorities.

2.10 DIVERSIFICATION OF RENTED HOUSING (FINANCING)

The Methods Used

2.10.1 A new move devised by Sheffield City Council could provide considerable scope for creative accounting by many authorities. The scheme involves a partnership between the authority and the private sector to provide or renovate housing stock. The land is disposed of to, for example, a housing association which raises money for the development privately. The housing association then uses the Council as managers and gives them 100% nomination rights for tenants. The Council in turn gives the housing association a revenue deficit subsidy to make up the difference between the fair rents to be charged and the cost of finance. Therefore in practice the scheme will provide municipal housing but in such a way that capital expenditure does not score for control purposes.

Counter-Actions Taken

2.10.2 The Minister for Housing announced on 5 February 1987 proposals to give local housing authorities a new explicit power to provide financial and other assistance towards the provision of private rented accommodation. The assistance may be in the form of both capital and revenue contributions. The Secretary of State's consent is required for the giving of such assistance, whether under existing powers or the proposed power. The provisions enshrining these proposals were introduced in the Local Government Bill but were subsequently deleted in order to secure the Bill's passage before the dissolution. The provisions have been reintroduced in the new Local Government Bill.

2.11 INTEREST RATE SWAPS (FINANCING)

The Methods Used

2.11.1 Interest rate swaps basically involve the exchange of a fixed interest rate liability for a variable one (or vice versa). There are a number of different ways in which this principle can be put into practice. In the simplest form of arrangement the authority will be paying interest at a fixed rate on a loan (probably from the PWLB), and a bank will agree to pay the authority half-yearly amounts equal to these interest payments. In return, the authority pays the bank interest on the amount of the loan at a variable half-yearly rate. The local authority will benefit from any favourable differential between the fixed and variable rates. The main attraction is however the payment of a large front-end fee or premium by the bank, in lieu of part of the future interest payments; this lump sum will be discounted to take account of the interest that would accrue if it were invested. The authority will thus obtain a one-off capital receipt, but at the expense of higher revenue costs in the longer term, in the shape of the differential between its fixed payments on the loan and its abated future income from the bank.

The Scale of the Problem

2.11.2 Five London Boroughs are known to be involved in or to be finalising interest rate swaps. Haringey have arranged two deals involving interest on £180m of debt, with a front-end premium of £29m; Islington have a series of deals amounting to £125m, with a premium probably of around £20m; and Brent have been trying to negotiate a complicated scheme, involving up to £200m of debt, and using Harlow DC and other authorities as intermediaries. Hackney are thought to be benefitting by £3m from interest rate swaps, and Camden are reported to have an interest rate swap with a premium of £10m. This information is not comprehensive, and further schemes may exist. It is a matter of concern that the authorities concerned are probably exploiting the availability to them of borrowing on preferential terms from the PWLB, and lending on through these deals.

Counter-Actions Taken

2.11.3 No action has yet been taken to combat these schemes, which are a relatively new development in local authority finance, though well-known

elsewhere in the financial world. It is, however, arguable that the front-end premia are in law a form of borrowing, and thus subject to control. The District Auditor is also now considering court action against Haringey's proposed use of the premium for revenue purposes.

2.12 PARALLEL LOANS

2.12.1 Another form of creative accounting known to be in use by local authorities is the parallel loan. An authority borrows a relatively small sum from a bank at an extremely high interest rate, whilst at the same time the bank places a much larger sum on interest-free deposit with the authority. The interest payments on the smaller sum provide the bank with an acceptable return on its capital, but the larger amount does not score as borrowing by the authority. No reliable information is available about the scale on which this device is being used.

2.13 THE AGGREGATE EFFECTS OF CREATIVE ACCOUNTING

2.13.1 It can be seen from the preceding paragraphs that local authorities can use creative accounting/financing either for capital or for current expenditure purposes. On the capital account side, the aim is essentially to find ways of financing capital expenditure which do not score as borrowing or as prescribed expenditure in any given year. On the current account side, the aim may be either to avoid the loss of block grant by supporting the provision of services in ways which do not count as total expenditure in the year in question, or else (for rate-capped authorities) to find alternative sources of income to make up for the loss of the rate income on which they would otherwise have relied to support their spending plans. In many cases the interrelationship between the capital and current benefits of a scheme or series of schemes may be complex. For example, the capitalisation of housing repairs may be undertaken to reduce the level of rate fund contributions to the Housing Revenue Account, with consequent block grant benefits;but the capitalisation may in turn (until the recent change in the rules) have been supported by a deferred purchase arrangement which would not have scored as prescribed expenditure.

2.13.2 Table 5 summarises the information presented in the preceding paragraphs, and shows the aggregate impact of each of the main types of creative accounting on the Government's local authority expenditure controls. For each

of the years 1987/88 - 1990/91 figures are given for the value of the assets acquired by authorities, the expenditure scored for block grant and capital control purposes respectively, and the net benefit to the authorities. It has been assumed that only a proportion of the advance leasing arrangements that have been secured will actually be used in future years, because of the loss of tax benefits; it has also been assumed that the revenue contributions to finance leasing will be made in five equal instalments starting in the year the asset is acquired. Small deferred purchase schemes arranged in the 1970s, of the scale that will still be exempt from control under the proposed new regulations, have been ignored.

2.13.3 The table suggests that the total net gain to authorities begins to decline steeply in 1989/90, and by 1990/91 has been converted into a net cost of £400m. Substantial costs will continue to be incurred as a result of existing commitments for several subsequent years.

3. ASSESSMENT OF POSITION OF INDIVIDUAL AUTHORITIES

3.1. INTRODUCTION

3.1.1 The previous section looked at the overall scale of the creative accounting problem. This section considers the position of individual authorities, and assesses both the magnitude of the commitments they have built up and the degree of risk that they will be unable to meet those commitments in future years.

3.2. INFORMATION

3.2.1. The Group has noted that information about creative accounting deals, and their future costs, is patchy. The monitoring sub-group has relied on such Council papers (some returned within the rate limitation process) and newspaper reports as are available, and informal contacts with the Audit Commission, the PWLB and the Bank of England. This is not satisfactory. DOE is therefore taking Counsel's opinion on whether the Secretary of State's general power to seek information from local authorities under Section 230 of the Local Government Act 1972 could be used in this context. The sub-group will in any case continue to update the information held about individual authorities, their use of creative accounting, and the alternative means available to them to balance their budgets.

3.2.2. On the basis of available information we do not therefore have a comprehensive picture of authorities' underlying budget strategies. However, the monitoring sub-group has drawn up detailed profiles of the 20 authorities thought to be most heavily engaged in creative accounting. These are:

+ *	Basildon	*	Islington
*	Brent	+ *	Lambeth
*	Brighton	+ *	Lewisham
+ *	Camden	+	Liverpool
+	Ealing	+	Manchester
+ *	Greenwich	*	Newham
+ *	Hackney	*	Sheffield
	Hammersmith and Fulham	+ *	Southwark
+ *	Haringey	+ *	Tower Hamlets
+ *	ILEA	+	Waltham Forest

Fifteen of these authorities, marked with an asterisk above, are rate - or precept-limited in 1987/88. The fourteen marked with a cross will be rate-limited in 1988/89.

3.2.3. The sub-group's analysis has concentrated on the revenue aspects of the problem, and in particular on the means by which the authorities are planning to bridge their "funding gap". (The funding gap is defined for these purposes as the difference between the authority's underlying expenditure commitments and the expenditure it can fund from its rate and block grant income; for a rate-capped authority the latter figure is its prescribed Expenditure Level.) Where possible an indication of the future costs of financing devices has also been included. Although considerable areas of uncertainty remain, these profiles demonstrate the sort of strategies being employed by these authorities to balance their budgets in the short term, and indicate some of the longer-term prospects. The following paragraphs summarise what can be learnt from them.

3.3. THE POSITION IN 1987/88

3.3.1 The 20 authorities examined have a total funding gap in 1987/88 of £633m, as shown in Table 6. This represents some 14% of their total underlying expenditure, ranging from 31% for Islington to 1.9% for Waltham Forest. For the most part the authorities appear to have been successful in setting up creative accounting schemes to bridge these funding gaps, although some (Haringey, for example) have apparently had difficulty in finalising the deals they were negotiating for. Following a statement by Mr Ridley that Government did not stand behind local authority debt, there have also been reports that the financial markets have been beginning to look more closely than hitherto at the possible risk attached to some of the more specalised deals proposed, and have either been declining to lend or have been lending at more expensive rates. Nevertheless, it is not thought that any of these authorities are in immediate danger of financial collapse. The most difficult case is Haringey, where the auditor has reported adversely on the propriety of some of the devices that have been adopted to balance the books this year; if these arrangements are not allowed to stand, the authority will have difficulty in meeting its commitments later in the year unless it can re-adjust its budget. This issue has yet to be resolved.

3.3.2. By far the largest part of this £633m revenue funding gap is being met by capitalisation of repairs (£315m), financed in part by deferred purchase. Drawing down of special funds accounts for a further £132m, and lease/leaseback or sale/leaseback for £71m. Other creative accounting devices, such as interest rate swaps, changed sinking fund rates and use of superannuation funds, provide £45m of benefits this year, and other, unrepeatable items of income (such as rate fund balances carried forward, Residuary Body receipts, and so on) amount to £37m. This leaves £33m unaccounted for, which must be attributed to unidentified creative accounting schemes if the assumption that all authorities have found means of financing their underlying levels of expenditure this year is correct.

3.3.3. One example is Hackney, where since a strongly-worded District Auditor's report in July 1986 on their financial difficulties, the Council have undertaken a major shift towards capitalisation of repairs and maintenance. The revenue

savings from £15m of capitalisation were taken forward in rate fund balances to help bridge their £35m funding gap in 1987/88. Further capitalisation of £14m in the current year, together with £3m drawn from special funds and benefits from interest rate swaps amounting to a further £3m, account for the rest of the gap.

3.4 THE POSITION IN 1988/89 AND BEYOND

3.4.1. The calculation of the 1987/88 funding gap can be rolled forward to 1988/89, by increasing underlying expenditure in line with recent trends for each authority and using either 1987/88 underlying income or, for rate-capped authorities, provisional Expenditure Levels. The resulting figure therefore represents a funding gap which can be bridged by reductions in expenditure, by rate increases (assuming no increase in block grant entitlement) for non-rate-capped authorities, by increases in other income, or by further creative accounting. This inevitably crude calculation, which takes no account of particular problems such as large loan repayments facing individual authorities next year, suggests an aggregate funding gap for these 20 authorities of £982m (or 20.7% of underlying expenditure) in 1988/89. The gap ranges from 36.4% of underlying expenditure for Basildon, to 11.6% for ILEA.

3.4.2. Of this £982m, only some £237m, at the most optimistic assessment, is covered by existing financing arrangements. In Camden, for example, it is thought that benefits amounting to approximately £28m may again be available in 1988/89 from the existing capitalisation arrangement and lease/leaseback scheme on which they are relying in 1987/88. This will leave a funding gap of £35m to be covered by other means.

3.4.3 In addition, the position is exacerbated for some authorities in 1988/89 by the need to accommodate new or increased repayments on existing deferred purchase deals. In Lambeth, repayments are due to commence on an £11m deferred purchase deal, with a payment of £2.4m. In Liverpool, repayments on deferred purchase deals are increasing from £3m in 1986/87 and £9m in 1987/88 to £16m in 1988/89. The problem of new repayments affects more authorities in 1989/90 and later years. In Brent payments on a lease/leaseback deal start in 1989 at a net cost of at lest £6m a year until 2007, whilst in Sheffield repayments of the order of £20-25m are due on a deferred purchase scheme in 1989/90. Islington's

position becomes more difficult in 1990/91 and later years as deferred payments accelerate and the benefits of a lease/leaseback deal ran out. The extent to which such deals can be refinanced and their costs spread over a longer period is not known. In most cases where repayments count as prescribed expenditure for capital control purposes, it will be necessary to meet them from the prescribed proportion of capital receipts or borrowing allocations, at the expense of an authority's capital programme. If repayments are non-prescribed expenditure, then the full amount of capital receipts may be used.

3.4.4. For the 6 authorities out of the 20 who are not rate-capped in 1988/89, the funding gaps remaining after taking account of known creative accounting facilities total some £128m. If no further deals were entered into, and no other measures were taken to reduce net expenditure, substantial rate increases would be required to cover these gaps, as shown in Table 8. The 14 rate-capped authorities will not of course enjoy the same freedom to pursue this option of high rate increases. Average increases of 52%, ranging from 100% for Greenwich and other authorities to 12% for ILEA, would be required to meet these gaps. The extent to which any of the gap is met from the rates will depend on the Secretary of State's consideration of applications to redetermine Expenditure Levels, and of rate limits. If as a result of Government counter-measures to date, and increasing caution on the part of the financial markets, creative accounting deals become increasingly unattractive or difficult to secure these authorities will have to look to reductions in net expenditure as an alternative means of bridging their revenue gaps.

3.5. THE SCOPE FOR REMEDIAL ACTION

3.5.1. All 20 authorities are, by definition, high spenders. Their total underlying expenditure exceeds their aggregate GRE assessment by £1412m, or 47%, ranging from 113% for Basildon to 19% for Ealing. To the extent that the GRE methodology takes account of local authorities' differing needs to spend in order to provide a standard level of service, this excess itself implies that these authorities should have considerable scope for reducing their net revenue expenditure to more reasonable levels. It is, however, less obvious where in their budgets the authorities would chose to make major savings, or how quickly these could now realistically be expected to be delivered.

3.5.2. However, certain features stand out from the profiles of individual authorities' positions. For example, 13 of the authorities have budgetted to make rate fund contributions totalling £257m (or 11% of their underlying expenditure) to their Housing Revenue Accounts in 1987/88. 12 of the authorities have raised their rents by significantly less than the Government's guidelines between 1983 and 1986. 5 of them made rate fund contributions to their Trading Services Accounts totalling £4.2m in 1986/87. 15 of them had sold a significantly lower proportion of their housing stock than the average for their class of authority, and 15 also had significantly higher levels of manual staff than the class average.

3.5.3. Another point of interest is that all of these authorities, except Brighton and Hammersmith and Fulham (whose holdings at less than a hectare are negligible) and ILEA, have substantial portfolios of land suitable for residential or commercial development. Sites shown on the Land Registers as owned by these authorities total 824 hectares, and according to DOE have an estimated value (based on median figures for each local authority area without inspection of individual sites) of some £859m. There is, however, an inevitable mismatch between resources and funding gaps: Southwark, for example, have 54 hectares of development land worth over £306m compared with a remaining 1988/89 funding gap of £20m, whilst Hackney have a remaining gap of £32m but development land worth only £8.8m. And even if these assets could be promptly realised their relevance to the authorities' revenue funding gaps is indirect, as the receipts could not be used to meet current expenditure needs. The receipts could, nevertheless, in principle help to pay off existing debts, or could be invested to earn interest, in both cases removing some of the burden of repayments from the rate fund revenue account. In addition, the prescribed proportions of the receipts can be used for capital purposes in addition to authorities' approved borrowing, and thus help to ensure that genuine capital programmes are not entirely squeezed out by the future consequences of creative acounting.

3.5.4. A similar source of potential receipts might be increased sales of housing. Those authorities out of the 20 who have sold less than the appropriate class average proportion of their stock have fallen short of the average by, in total, some 49,000 dwellings. Were they to be able to dispose of these dwellings the proceeds might amount to some £800m.

3.5.5. We are not suggesting that the factors identified in the profiles add up to a solution for one or all of the individual authorities. They do, however, indicate that there are areas where action can be taken by the authorities to improve their financial position.

3.6. ATTITUDE OF AUTHORITIES

3.6.1. The major question is whether the authorities concerned are prepared to take the necessary steps to bring their finances back under control. We do not know the answer but there are some helpful signs. The Chair of the Association of London Authorities has pointed to the need for authorities to be more realistic in the policies they adopt given their financial circumstances. A number of authorities - eg Camden and Hackney - appear from press reports to be taking a hard look at the scope for economies. Two authorities, Islington and Hackney, are co-operating in reviews by consultants nominated by the Audit Commission. At present there is little of the mixture of defiance of Government policy and the courting of collapse which characterised the early days of rate limitation. On the debit side, the monitoring sub-group has noted the poor level of financial management in many of the authorities concerned, which is exacerbated by the very high turnover of senior staff and the delays encountered in filling vacant posts. The Audit Commission paper on the management of London Authorities showed in January 1987 that, in 8 London boroughs, on average 54% of senior officers had left over a three-year period. These factors could seriously affect the ability of the authorities to turn matters round, even if the desire is there.

3.7. CONCLUSION: 1988/89 AND BEYOND

3.7.1. It is too early to make any confident predictions about whether these authorities will get through 1988/89. While they do have substantial funding gaps to cover the outcome will depend on the further availability of creative accounting devices, the willingness of authorities to make economies and, importantly, the eventual level of rates.

4. PROPOSED PRUDENTIAL REGIME PACKAGE

4.1. INTRODUCTION

The Need for the Prudential Regime

4.1.1. As noted in paragraph 2.1.2 above, the Government's response to creative accounting in local government has hitherto been piecemeal in nature, and has consisted of countering individual devices as they have arisen. Over the last few months, however, attention has focussed instead on the desirability of tackling the problem in a more comprehensive way, which would discourage all forms of creative accounting that enabled authorities to spend now and pay later (except within the ambit of the Government's conventional borrowing controls), and generally encourage prudent financial behaviour. This might be thought of as addressing the disease rather than the symptoms. To some extent the incentives for creative accounting will in any case be reduced with the introduction of the community charge and new grant system from 1990/91, as there will no longer be grant advantages to be had from the manipulation of total expenditure figures. Nevertheless, one of the strengths of the community charge, compared with the present rating system, is the enhanced accountability it will bring to local government expenditure; and the converse of this greater accountability is that authorities may well find that there are electoral advantages in deferring large increases in charges for a year or two. It will thus still be necessary to continue with the development of this comprehensive approach to the creative accounting problem.

4.1.2. It is unlikely that there is any single measure that can be taken which will itself provide a complete solution. The answer is more likely to lie with a package of related measures, that would together provide a suitable framework of prudent financial behaviour within which local authorities could act. The aim of the package would be to provide a graduated response to an authority which was engaging in financially imprudent behaviour, whilst leaving the Government maximum room for flexibility and judgement at each stage. Such a system is likely to depend to a large extent on prudential ratios, and work on these is at too early a stage for the Group to be certain that workable and effective ratios can be devised. However, a preliminary view of how the graduated response might operate is as follows.

4.1.3. As an authority's financial position worsened it would receive warnings from its Chief Finance Officer, the auditor and, possibly, the PWLB. Breach of a first prudential ratio (see sub-section 4.3 below) could signal to lenders that higher interest rates were in order and put Government on warning to be particularly careful about approving new projects for grant and grant payments themselves. The auditor might use his stop power to prevent actions which would make the authority's position worse. Approach to, or breach of, a second ratio could suggest the cessation of lending by the PWLB, and the appointment of overseers. Commissioners would follow only as a last resort if the authority failed to act on its own initiative to put its finances in order.

Impact of the Prudential Regime on Authorities

4.1.4. The prudential regime, as described in this section, cannot be fully in place for at least 2 years. While some elements - the strengthened role of the Treasurer, the auditor's stop power - should be enacted by mid 1988/89, others - prudential ratios, the revised definition of borrowing - will be well behind. That said, the regime could affect authorities in the following ways:

a) Authorities already in financial difficulty: the prudential regime will not solve existing financial difficulties, but it should prevent these authorities entering into further deals which increase their difficulties. Conversely, however, authorities' inability to negotiate further deals could make it impossible for them to bridge funding gaps and so precipitate collapse.

b) Other authorities: the prudential regime should prevent the spread of imprudence to the generality of authorities, if indeed there is any risk of that happening. The main response of authorities to the regime, however, is likely to be that it is yet another example of centralisation and is an unnecessary across the board reply to the problems of a small minority of authorities. The success of the prudential regime will depend to a large degree on convincing authorities in general that these measures will enable them to demonstrate their own good management and continuing

creditworthiness, and on avoiding so far as possible the inposition of unnecessry new burdens on the majority of authorities.

4.1.5. The remainder of Section 4 of this report describes the progress which has been made in working up prudential ratios and the other component elements of the prudential regime package, as follows:

Sub-section 4.2 Statutory Definition of Borrowing
4.3 Prudential Ratios
4.4 Auditor's Stop Power
4.5 The Role of the Treasurer
4.6 Payment of Exchequer Grant
4.7 Good Practice Certificate
4.8 Overseers
4.9 Role of the PWLB
4.10 Contingency Planning

4.2. STATUTORY DEFINITION OF BORROWING

4.2.1. Many of the forms of creative accounting discussed in Section 2 above - notably deferred purchase and lease/leaseback - which provide an authority with either money or money's-worth in the short term in return for a commitment to make a stream of payments in the future - are closely akin to borrowing. But they are not technically borrowing in the sense which it is taken to have in present legislation. If "borrowing" (or some other phrase more clearly reflecting a broader concept of the raising of local government finance) could be defined in such a way as to embrace the range of creative financing deals these could be made either impossible or at least much less desirable to local authorities, without the need for more piecemeal legislation. They could either be prohibited, or else caught by the limits imposed by central Government through the borrowing approval system.

4.2.2 The defining of borrowing could therefore be a key factor in tightening up on creative accounting/financing, and extremely helpful background to other elements of a prudential regime. An opportunity to introduce a new definition of borrowing exists in the review of the capital control sytem which is currently taking place. It is intended that the review should lead to legislation during 1988/89 on a new control system to be introduced in 1990/91.

4.2.3. At present the legislation does not define the term "borrowing". Legal advice is that it should therefore be taken to have its natural meaning, that is that it involves a purely financial transaction and does not involve, for example, the acquisition by the lender of any interest in an asset (other than a mortgage) as a consideration for the advance, or the passing of money from the lender direct to a third party who is providing goods or services for the authority. It therefore fails to catch devices such as lease/leaseback and deferred purchase, even though they have key features in common with borrowing.

4.2.4. Establishing a suitable definition of "borrowing" will not be straightforward. The difficulty is to extend the definition to make it wide enough to catch devices like lease/leaseback and deferred purchase without making it embrace too much. For example it is not possible simply to define borrowing as any transaction which leads to a commitment to future payments. Such a definition would catch a standard building contract and perhaps even such things as contracts of employment. Conversely, a redefinition which replaced the concept of "borrowing" by the concept of "raising money on security" would still be too narrow: in lease/leaseback the essential point is that the property concerned is theoretically disposed of and re-acquired, while in deferred purchase there is no specific security. Moreover, all of the devices currently in use are capable of variation at the margin, and other similar devices may be developed. Any definition should not therefore concentrate too closely on catching these devices in their present form, but should aim at more general applicability.

4.2.5. Two approaches to the construction of a revised definition have been identified: definition by inclusion or definition by exclusion. In the former case the definition would be built up from a number of specific items; in the latter case it would be arrived at by making exclusions from a more sweeping definition. Thus "fruit" might be defined as "apples and oranges and pears and...." or as "all food other than vegetables, meat, bread...."

4.2.6. The difficulty with the inclusive approach is its complexity. This arises firstly because of the need to distinguish between unacceptable devices and similar transactions which are unexceptionable; and secondly because of the need to try to catch a range of potential variant forms of the unacceptable devices. A complex provision is going to be its own worst enemy: despite our efforts to second -guess the next developments in creative accounting, ways will doubtless be found of sidestepping the letter of the law if it is too detailed. On these grounds, definition by exclusion looks the more promising approach at present.

Definition by Exclusion

4.2.7. A definition by exclusion, designed to prohibit deferred purchase and lease/leaseback, might be on the following lines:-

A local authority may not incur any liability to make payments in a future financial year other than by:-

(a) borrowing;

(b) entering into a contract of employment;

(c) entering into a contract for the carrying out for the local authority of works under which at least 90% of the amount payable by the local authority falls due within six months from the date of material completion of the works;

(d) entering into a contract for the acquisition of an interest in real or other property which has not been held by, or for the benefit of, the local authority within the preceding twelve months;

This is not a comprehensive list but is intended to show the type of transactions which might be excluded. The list of excluded, acceptable forms of transaction might indeed prove quite long, but because an acceptable transaction which fell outside the generally permitted categories could be the subject of a specific consent, the wording could be broader brush than under the other approach.

4.2.8. Further simplification might be possible if the exclusive approach were used to bring pseudo-borrowing activities within a general borrowing limit, rather than to define activities which were excluded from a general prohibition. This approach might work by issuing a limit on conventional borrowing and then making a provision that any other liability to make payments in a future year other than:

(a) under a contract of employment;

(b) in repayment of sums borrowed for periods of less than one year;

(c) etc;

should be deemed to score against that limit.

Any categories of activity left out of the exceptions would be intra vires but would be caught by the limit. There would be a trade off: the extent to which the definition could be simplified would depend on the degree of complexity which Ministers were prepared to contemplate in setting the limit.

Avoidance

4.2.9. The Group has also considered whether a provision similar to that in taxation legislation, preventing avoidance of the spirit of a statute by steering a careful course through its precise wording, might usefully be included in legislation on the new system. We note, however, that the Inland Revenue have in the past found such provisions difficult to apply, and that reliance on an anti-evasion clause of this kind would only be proof against judicial review if the definition itself were very tightly drafted. It nevertheless remains an avenue worth exploring further.

Conclusion

4.2.10. The Group recommends that :

a) work should continue on the development of a statutory definition of borrowing to cover "pseudo-borrowing";

b) this should be primarily directed to working up a definition by exclusion of transactions which would be deemed to score against a borrowing limit;

c) the aim should be to bring the new definition into force as part of the wider reform of the capital control system, planned for legislation in 1988/89, and introduction in 1990/91.

4.3. PRUDENTIAL RATIOS

Background

4.3.1. It is commonplace, in assessing the financial viability of a company or institution or even a country, to judge the relationship between its forward commitments and its ability to meet them. The idea of seeing if this approach

could be adapted to local authorities is being worked up by the Audit Commission. The aim is to define ratios between liabilities and the means to meet them which it would be imprudent for authorities to breach.

4.3.2. As part of the pattern of graduated response, we envisage two levels of prudential ratio. The first of these will be, in effect, an amber light; crossing it would alert lenders, the Government, the authority itself and its local taxpayers to the danger of over-commitment. The second will be a red light, and transgressing it would require instant action to retrieve the position; it might lead to the cessation of lending or the appointment of overseers. When nearing the amber light, question of professional judgement over precisely what should be included within the authorities' liabilities and net income will become important. There will therefore be a need for some professional to exercise his or her judgement in saying whether or not the prudential ratios have been surpassed. For regulated financial institutions, this judgement is taken by the supervisor. For local authority prudential ratios, the corresponding judgement is likely to have to be given by their auditor.

4.3.3. The purpose of prudential ratios is to provide a framework to assist those interested in the financial standing of an authority to make judgements; they are not intended to be mechanistic in their operation. Ideally ratios should:

a) warn members, electors and local taxpayers that their credit is being pledged recklessly by a body with taxing power over them. This links closely with the enhancement of local accountability through the new community charge;

b) warn potential lenders about the desirability of (or at least make them consider the appropriate rate for) further lending to an authority showing signs of over-commitment. Lenders would have to judge the likelihood of an authority being able in the short term to impose the size of rate or community charge increase necessary to service its debts, especially given policy on rate-capping;

c) warn Government to take extra care in giving project approval for grant purposes and in paying grant itself;

d) give the auditor a benchmark against which to issue warnings/public interest reports to an authority, or to use his proposed stop power.

It may not, however, prove possible in practice to define ratios which will fulfil all these functions. Work to date has been primarily directed at a) and d) above; the ratios so far produced have not been specifically designed with objectives b) and c) in mind, although they should provide some assistance in these areas.

Progress on the Development of Ratios

4.3.4. The local authority ratio between income and liabilities needs to cover as much as possible on both sides of the equation. The development work on the income side has so far included incomings from rates, block grant, trading income (though not in full), interest from revenue balances, interest received on mortgages granted, rents, and subsidy under the 1980 Housing Act. Debt figures have been taken from the standard returns of outstanding external advances. The definition will need to be extended to include liabilities under creative accounting deals on the one hand, and the netting off of liquid assets on the other hand. Some interim examples of the ratios of income to debt now emerging are attached as Table 7; figures are quoted for these randomly selected, but not untypical, authorities.

4.3.5. Although present figures are incomplete some main features can now be discerned. One of the first of these is that there is some considerable stability through a period of four years from 1982/83 to 1985/86 in overall ratios for England and Wales as a whole, for classes of authority, and for most individual authorities. The ratio of observed debt to income for the totality of authorities was 118% in 1982/83, in 1985/86 it was 121%, while in the intervening years it had dipped slightly. In some individual authorities, however, the ratio changed markedly over this period.

4.3.6 Second, there are marked differences in the ratios observed for different classes of authority. These differences arise from the nature of the services provided by classes of authority, with districts typically providing services (such as housing) which require capital investment and counties, for example, typically concentrating on more labour-intensive services such as education. The highest ratios on average are for inner London Boroughs and the non-metropolitan districts, both of which average around 300%. However, the range of variation in the non-met districts is rather wider than for the inner London Boroughs; this partly reflects the larger number of non-met. districts, and partly the incompleteness of the data so far used. Outer London Boroughs and the metropolitan districts have average ratios between 100% and 200%. Shire county ratios are very much lower, averaging 20 to 25% of income. The outlyer county (Cleveland) is around 80%; at the other end Dorset and Lincolnshire

County Councils appear to be running their debt down to zero. It appears from these figures that it may be necessary to set the ratios which will trigger concern and action at different levels for different classes. Inner London Boroughs and non-metropolitan districts might be grouped together, as might outer London Boroughs and metropolitan districts. Shire counties might have to be treated separately. Further consideration will need to be given to the justification for setting different ratios by class, given the fact that all authorities have (subject to Government actions on rate limitation) essentially the same taxing power to raise revenue to meet their commitments.

4.3.7. The present figures do not cover creative accounting deals in the statement of liability. Even so, boroughs and districts known to be engaged in creative accounting show at the top end of the ranges. The top three inner London Boroughs for instance are Islington, Southwark and Camden. It should be noted however that one or two other authorities that have been particularly economical (such as, for example, Kensington and Chelsea) appear in the upper middle range of these ratios. Low income and moderate debt figures, in combination, can produce a fairly high ratio. Amongst metropolitan districts, it appears likely that Manchester, Salford and Liverpool will have amongst the highest observed ratios. Sheffield's ratio has been growing fast. In outer London, Haringey is in the lead with a ratio close to that for Manchester.

Need for Further Work

4.3.8. The Group concluded that a considerable amount of work still needed to be done to be certain that ratios would be workable and produce worthwhile results. No view had yet been formed of the level at which the first and second prudential ratios might be set, for any class of authority. It would also be necessary to be certain that ratios could be devised in a form which was acceptable to the majority of authorities. Without such acceptance by local government, ratios would founder. Work was needed on:

a) the collection and processing of data;

b) the form in which the ratios were expressed, in order to provide a clearer signal to lenders about creditworthiness;

c) the extent to which different ratios were required for different types of authority;

d) the maturity pattern of authorities' liabilities and the relation of interest plus repayment flows to available income. This would be of particular interest in assessing the risk of financial collapse;

e) the way in which the ratios would be monitored by the auditor and his views passed to interested parties;

f) the relationship between prudential ratios and any new capital control scheme, and the extent to which Government capital allocations to individual authorities should acknowledge the existence of ratios.

4.3.9. It is proposed that work on items a) - e) should be taken forward by the Audit Commission, with the aim of exposing initial proposals to the local authority associations in September; this might then lead to wider discussion and the issue of a full consultation paper in October. Work on f) will be principally for the Department itself to take forward.

Conclusion

4.3.10 The Group recommends that the work outlined above be progressed urgently, with a view to having considered proposals available in October.

4.4. AUDITOR'S STOP POWER

4.4.1. This proposal is similar to, but goes somewhat further than, one put forward in the Widdicombe report. It has two main features. First, it would enable the auditor to issue an order preventing an authority from incurring unlawful expenditure or losses due to wilful misconduct. At present the auditor can only act retrospectively. Secondly, based on a statutory extension of the concept of fiduciary duty, it would enable him similarly to pre-empt acts which appeared to him highly imprudent. The latter aspect is most relevant to combating "creative accounting".

4.4.2. The Secretary of State for the Environment has recently written to colleagues setting out his proposals in more detail. To provide a firm basis in law for the exercise of the stop power in cases of gross imprudence it would be necessary to create, in addition to the currently non-statutory fiduciary duty owed by an authority to its ratepayers, a new statutory duty on local authorities to act impartially as regards the differing interests of:

a) present ratepayers/community charge payers;

b) future ratepayers/community charge payers;

c) those who currently pay fees/charges for services;

d) those who in the future will pay fees/charges for services; and

e) present beneficiaries from services; and

f) future beneficiaries from services.

4.4.3. In particular the authority would be required to be satisfied that anything done by it would not favour unduly one or more of the groups mentioned above at the expense of one or more of the other groups, and that any financial burdens which are likely to arise as a result of such action and which are to fall on the ratepayers/community chargepayers in any future year are commensurate with the resulting benefits which it expects them to enjoy in that future year or thereafter. The auditor could intervene to issue a stop notice where he believed that an authority had not considered or, in the end, complied with this new duty. Where an authority failed to comply with an order the auditor could take rapid enforcement action through the courts, or initiate action to surcharge and disqualify those responsible for any unlawful expenditure or loss. There would be procedures for appeal to the courts against the auditor's decision to issue a stop notice.

4.4.4. The first part of these proposals, which has the support in principle of the Audit Commission, represents a fairly clear cut extension of the auditor's existing powers. If Ministers are content it is proposed to introduce clauses to this effect in the Local Government Bill. The second part, however, breaks new ground and is likely to prove highly controversial with local government; further discussions between Ministers will therefore be required before any decision is taken on whether to proceed with this measure and if so by what means.

4.4.5 The Group has noted these developments, and considers that although the second part of the proposed new duty would not eliminate creative accounting, it would be a worthwhile element in the overall prudential regime if it enabled the auditor to prevent those deals which would tip an authority from an acceptable

financial equilibrium between means and commitments to something which was highly imprudent. Such a case might be where an authority entered into a scheme to defer substantial liabilities, so placing a clearly unreasonable burden on future ratepayers. This part of the proposal would interlock closely with the proposals on prudential ratios - which would provide a useful indication of when an authority's future commitments were becoming excessive - and on the role of the Treasurer (see sub-section 4.5 below), which would similarly support the judgement of the auditor in these cases. The Audit commission has, however expressed some concern that the provisions will be difficult to draft in a way that does not lead to the auditor's judgement on the balance of interest between groups being frequently tested in the courts.

4.5. THE ROLE OF THE TREASURER

4.5.1. The Group's previous report noted the Department of the Environment's proposals for strengthening the position of local authority Treasurers in relation to the legality and propriety of the expenditure of their authorities. The key points in the proposals were:

a) the Treasurer (or Chief Finance Officer) would be placed under a statutory duty to report to the authority on any decisions, acts or omissions of the authority which would in his opinion lead to unlawful payments, deliberate loss, or expenditure in excess of available resources;

b) the authority would, conversely, be required to refrain from actions which were the subject of a report until it had considered the report;

c) in order to reinforce the professional status of the Treasurer, principal councils and joint authorities would be required to appoint to this post only members of the recognised professional accounting bodies (or persons already holding this office at the time the provisions come into force).

4.5.2. The Secretary of State for the Environment has now written to colleagues seeking their confirmation that they are content for legislation on these points to be included in the Local Government Finance Bill. The Group has noted these proposals, and considers that they will constitute a further useful component of the prudential regime package. They would not alter the legal boundaries of

what an authority may or may not do, nor would the authority be prevented from proceeding to act unlawfully once it had considered the Treasurer's report. Nevertheless, this measure would exert some further restraint on authorities, who would be forced to consider the consequences of their decisions. Most importantly, it would provide the auditor (who would receive a copy of any report) with firm grounds for action, possibly including the issuing of a stop notice in appropriate circumstances. These proposals should thus be seen as closely related to those concerning the auditor's stop power, described in sub-section 4.4 above.

4.6. PAYMENT OF EXCHEQUER GRANT

4.6.1. The Group has considered whether, as one of the measures in the prudential regime package, powers should be taken to allow Ministers to withhold grant - in particular block grant - from financially imprudent authorities on a basis more clear-cut than at present.

Background: The Position under Present Legislation

4.6.2. Advice obtained from Counsel by DOE in July 1985, focusing on the position of the Accounting Officer, was that:

a. where discretionary grants (such as UP grants) are concerned, "firm evidence of improper conduct or illegality concerning financial matters" would constitute good grounds for withholding grant, but the Accounting Officer would have to exercise judgement in individual cases;

b. in the case of mandatory grants (such as RSG), grant could only be withheld where there was "firm evidence that the making of a payment would constitute knowing assistance in the execution of dishonest or illegal design".

In certain unusual circumstances such as defiance of a relevant Court Order the Accounting Officer would be required to withhold payment of both discretionary and mandatory grants.

4.6.3. Counsel's opinion is broadly consistent with the requirement in Government Accounting that the Accounting Officer should take steps to avoid making any payment in circumstances in which the requirements of propriety or regularity of expenditure might be infringed.

4.6.4. Although examples of discretionary grants actually being withheld are few, DOE not infrequently acts to protect its Accounting Officer, in cases where there is concern about financial management within or by local authorities or where there is reason to suspect impropriety or illegality in the handling of funds, by suspending discretionary grant approvals so that no entitlement to grant arises. The circumstances in which mandatory grants (notably RSG) can be withheld are much more narrowly drawn than mere suspicion of impropriety or illegality. Unless there is firm evidence that RSG grant payments would constitute "knowing assistance in the execution of dishonest or illegal design", there is no power for the Department to stop payment. This has never yet arisen.

4.6.5. It is far from certain that the likelihood of default would in itself justify the withdrawal of mandatory grants. Although imminent default (or the breach of a second prudential ratio) might arouse doubts about the payment of certain discretionary grants, if the Accounting Officer could no longer satisfy himself that moneys would be applied to the purposes or projects for which they were granted, it would not necessarily constitute the evidence of "knowing assistance..." required before mandatory grants could be withheld. The withdrawal of grant would, on the other hand, have considerable repercussions in precipitating collapse. Means would also have to be found to ensure that creditors with legitimate claims on the authority's withheld grant revenues received payment. The Department concerned would therefore need to be absolutely certain that in any given case withdrawal of grant was both justified and necessary to protect the Accounting Officer. Further advice from Counsel would be required before action was taken.

The Case for Taking New Legislative Powers

4.6.6. A new statutory power could make it easier for the Secretary of State to withhold grant. This would enable greater financial pressure to be applied to authorities that persisted in acting irresponsibly, and might persuade them to accept the appointment of overseers rather than face a real threat of loss of grant. There are, however, strong counter-arguments:

i. the Secretary of State's position would be strongest if the withholding of grant were linked to objective financial criteria, for example the proposed prudential ratios, but loss of RSG would be very likely to precipitate financial collapse and such a mechanistic approach would leave little room for discretion in taking this step;

ii. even if there were room for the exercise of discretion, once the power was in existence the Secretary of State might come under considerable pressure to withhold grant;

iii. the power would be a draconian measure, which could raise questions about the position of companies doing business with authorities in good faith, and would be likely to arouse considerable opposition from local authorities at large.

Conclusion

4.6.7 The Group recommends that no new powers are taken to withhold grant payments, and that Government should operate on the basis of existing Counsel's opinion, taking further advice when necessary. It may, however, be necessary to look again at this issue in the light of developments on prudential ratios.

4.7. GOOD PRACTICE CERTIFICATE

4.7.1. The Group considered whether the Government should proceed with the Audit Commission's proposal to introduce an auditor's good practice certificate as an element in the prudential regime package.

Background

4.7.2. Section 15(1) of the Local Government Finance Act 1982 places a duty on the auditor in auditing local authority accounts to satisfy himself that, inter alia, the authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice which the auditor is obliged to follow makes it clear that the ability of authorities to achieve value for money depends upon the existence of sound arrangements for the planning, appraisal, authorisation and control of the use of resources. The auditor's responsibility is to verify independently that these arrangements are in place and are effective. Where the auditor is dissatisfied as to those arrangements he can issue a report in the public interest or report his concerns in a management letter.

Proposal

4.7.3. Some authorities repeatedly fail to take action to remedy unsatisfactory matters drawn to their attention by the auditor in management letters, qualified accounts and public interest reports. It was therefore proposed that it should become normal practice or a requirement for local authorities to be in possession of a current certificate from the auditor attesting to the good order of their financial management systems and procedures. Lack of a current certificate would alert central Government departments to the need for special care and deliberations in financial dealings with the authority, and might serve also as a warning to potential lenders. Where the auditor was dissatisfied with the generality of an authority's financial management he could refuse a certificate. Where this dissatisfaction was limited to specific matters he would have discretion to issue a qualified certificate. If at any time after giving or renewing a certificate he became dissatisfied as to the financial systems and practices in operation in the authority he could withdraw or qualify his certificate.

Group's Consideration

4.7.4. The Group has considered in detail the proposals for certification which have so far been developed, and believes that if implemented these could lead to tighter financial management procedures in those authorities where systems have decayed. However, the good practice certificate will focus on the quality of financial management rather than on deliberately imprudent behaviour, and on consideration the Group believes that it would be preferable for the development of the good practice certificate to be taken forward separately by the Audit Commission in due course, and not as part of the prudential regime package to which it would add little. It is unlikely that this proposal, although of interest, will justify other than a relatively low priority.

Conclusion

4.7.5. The Group recommends that further work on the proposal for a good practice certificate should be taken forward by the Audit Commission in due course, but not as part of the prudential regime package.

4.8. OVERSEERS

4.8.1 At its meeting on 5 March MISC 109 considered a proposal for the appointment of overseers, as a means of tackling the imminent breakdown of local government in a particular area. The Secretary of State for the Environment was invited to work these proposals up further, in conjunction with other Ministers. The Working Group has considered a detailed paper subsequently prepared by DOE, and the comments of departments (DHSS, DES and Home Office) who are not represented on the Working Group.

Background

4.8.2. The proposal put forward by DOE is that overseers would be appointed in those cases where an authority was on the brink of financial collapse, and the Councillors could see no other course open to them, if they were to avoid the appointment of Commissioners, but to acquiesce in the measures necessary to restore the authority's financial standing. The overseer would be appointed by the Secretary of State, who would have a wide discretion on whether or not to appoint, depending on the willingness of the authority to co-operate and the nature of its problems. The role of the overseer would be to provide advice and to create the conditions in which the authority could put its own house in order; he would approve, monitor and enforce (in particular through a control on an authority's ability to borrow) compliance with a financial recovery plan. He would also bring with him certain distinct financial benefits:

a) so long as the authority produced and complied with an recovery plan acceptable to the overseer there should be no need for Government to contemplate the withdrawal of mandatory grants;

b) it is proposed that the overseer should have a statutory power to authorise the levying of a substitute rate in-year, and to seek the Secretary of State's approval to disapply any rate limit in the first year of his appointment (he would also advise on the setting of rate limits in future years);

c) there would also be a statutory power for the overseer to advise the PWLB on lending, and if necessary to secure special borrowing arrangements from the PWLB in circumstances in which it would not otherwise countenance further lending to the authority.

4.8.3. The Group has, however, questioned whether there is merit in a statutory scheme for the appointment of overseers by the Secretary of State at all. It has been argued that it would be equally satisfactory - and distance Government from the arrangement - if the authority itself was simply, on its own initiative, to appoint a private consultant to help it formulate a recovery plan. This might be put forward as part of an application, by a rate-limited authority, for determination of its Expenditure Level for the following year. Alternatively, in cases where financial collapse was more imminent than that, it might be feasible for the Secretary of State, once he had approved a recovery plan, to have power to provide some immediate relief in the form of authorisation of a substitute rate or special borrowing consents.

4.8.4. The Group has also considered whether the overseers proposal, however this is eventually framed, should be presented publicly as part of the prudential regime package, or (as hitherto envisaged) kept back as a contingency measure. The problem with the latter course is that if the option is not known about authorities will not be in a position to choose to take advantage of it. On the other hand, early announcement (and legislation if necessary) might stir up opposition to the proposal, create unnecessary hostility, and highlight the issue of authorities' financial difficulties in an unhelpful way. On balance the Group believes, however, that early legislation would be advantageous.

Conclusion

4.8.5. It is evident that further work is needed on both of the alternative approaches outlined above, and their respective advantages and disadvantages. The Group agreed that a further detailed paper, exploring the options, should be prepared for Ministers in September. This should also consider the question, raised in particular by DHSS, of the extent and nature of the involvement that Ministers would have, under either approach, in ensuring that any recovery plan embodied acceptable levels of service provision. Attention should also be given to the practical problems that may arise, for example if an authority's staff refused to co-operate with an approved recovery plan.

The Group therefore recommends that:

a) a detailed paper setting out alternative schemes for the formulation of recovery plans by authorities in financial difficulties and their monitoring either by private authorities or by overseers appointed by the Secretary of State, should be presented to Ministers in September;

b) the proposal eventually adopted should be presented publicly as part of a prudential regime rather than kept in reserve as a contingency measure.

4.9. THE ROLE OF THE PUBLIC WORKS LOAN BOARD

4.9.1 The Group considers that a prudential regime of the kind now being developed would need to be supported by appropriate arrangements for central Government lending to local authorities. The existence of a class of authorities whose behaviour was publicly held to be imprudent, according to more or less objective prudential tests, or whose affairs were the subject of advice and scrutiny by Government-appointed overseers, would create unfamiliar and difficult problems for the PWLB as presently constituted. In addition, changes in lending arrangements may be a way of bringing a degree of market discipline to bear on the more extreme authorities.

4.9.2 The Group's work on differential PWLB rates is summarised in Annex B. The viability of such a scheme depends critically on developing prudential ratios into analytically satisfactory tests of creditworthiness. Even if that is possible, it is clear that differential PWLB rates could only be a partial answer to the problems posed by the most extreme authorities. The Group recommends that other options, including the setting up of special arrangements separate from the PWLB for regulating lending to authorities who are close to financial collapse, should be worked up for the Group's consideration.

4.10. CONTINGENCY PLANNING: COMMISSIONERS

4.10.1. There is no assurance that the prudential regime package will prevent authorities who have already accumulated large forward commitments from going over the brink. It is therefore necessary to continue to have contingency plans in hand to cope with this eventuality.

4.10.2. The Group has considered briefly the action which central Government might take in the event of financial collapse and/or the collapse of service provision in certain local authorities, and concludes that there is no realistic alternative to the appointment of Commissioners to take over the full range of the Council's functions and responsibilities. Such an approach offers both the simplest and most clear-cut course of action, which would enable central Government to intervene firmly and effectively to protect the interests of local people, and would offer the easiest route back to normality.

4.10.3. Draft legislation for the appointment of Commissioners was prepared in 1985, and is now being reviewed by DOE officials. Some amendments will be necessary, principally to take account of the creation of joint authorities in the metropolitan areas by the Local Government Act 1985. The Group notes that a further submission on the state of play on this will be made to DOE Ministers in September.

WGFP

6 August 1987

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SPECIMEN PROFILE ANNEX A

Hammersmith and Fulham

1987-88: funding gap of £15m

The Council's financial strategy for 1987-88 involves an assumption of £8.6m slippage in planned growth of £18.3m. However, by increasing rates by 127% they have built up balances by £25m for the eventuality that the slippage might not occur. The quoted funding gap of £15m is based on underlying expenditure of £101m and total expenditure met from rates and block grant of £86m which assumes that the £8.6m slippage does not in fact take place. If slippage was as much as the Council suggest the funding gap would fall to nil after taking account of increased block grant entitlement.

The existing gap is being met largely from capitalisation (£8m) and special funds (£3m). The Council are also believed to have a £100m deferred purchase facility arranged through Guinness Mahon.

On this basis we have no evidence to suggest that they will be unable to meet their commitments this year.

1988-89: funding gap of £22m

A roll-forward budget of £108m for 1988-89 has been estimated by Conservative councillors.

Rate arrears (£5.0m) 6.6% of rate collectable in 1985/86 compared with class average of 5.1%. If written off this could further increase expenditure.

Options

A further rate increase of about 75% would be required in 1988-89 to meet a funding gap of £22m.

At £101m their 1987/88 underlying total expenditure is £26.5m (36%) above their GRE of £74.5m

£1 per week on rents would increase the Council's annual income by £0.9m

Some private contractor use - window cleaning, catering and maintenance of entire vehicle fleet. (All entered into prior to Labour gaining control in May 1986). It is not known if the council now plan to pull out.

The Council has sold 1773 dwellings, 6.7% of its total stock. Class average - 11.4% of stock sold.

In November 1986 the Council owned 789 vacant dwellings - 4.2% of total - Class average 5.6%

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ANNEX B

THE ROLE OF THE PUBLIC WORKS LOAN BOARD

1. The Group has considered the scope for the PWLB to charge local authorities differential interest rates, reflecting their financial standing. The case for "tiering" is two-fold. Where there are demonstrable and significant differences in local authority creditworthiness, the Accounting Officers for the NLF and PWLB may feel they have a duty to charge higher rates, under the National Loans Act 1968, to compensate for assuming higher risks. Action by the PWLB to charge premium rates would also be a clear signal that the Government believed some authorities to be genuinely more risky than others. Arguably, indeed, official or semi-official warnings about the credit standing of the most extreme authorities are unlikely to be fully credible, in the absence of a more selective approach by the PWLB. Nevertheless, there are problems to be overcome in developing any scheme of differential interest rates, which relate above all to the criteria to be used in applying higher rates. The prudential ratios now being developed may offer a way forward. But this is by no means certain at this stage.

2. These problems arise because the PWLB is an independent statutory body and it is for the Public Works Loan Commissioners, not the Treasury, to decide whether or not they should lend to an individual authority. But, if the PWLB does lend, it is for the Treasury - and the Treasury alone - to decide what rates of interest should be charged. The Treasury's powers to set PWLB interest rates are set out in Section 5 of the National Loans Act 1968. Under the terms of this Act the Treasury must set a rate for any loan, or class of loans, at a rate at least sufficient to prevent a loss if it had itself to borrow to finance the loan and may "take into account any consideration justifying a rate higher than that [minimum rate]".

3. At first sight this seems to give the Treasury a wide discretion to set a higher rate of interest on loans to particular local authorities. And, in principle, it should be possible to introduce a rate or rates of interest on all PWLB loans to certain authorities, pitched at say 1 or 2 per cent above the lowest rates charged by the PWLB. In practice, however, the Treasury's discretion to operate such a scheme would be far from unfettered. And devising a scheme likely to be proof against legal challenge is far from straightforward.

4. Taking the National Loans Act as a whole, the courts can be expected to say that the Treasury's power to set a rate of interest above the statutory minimum for some authorities had to be exercised for prudential reasons and not simply to penalise authorities subject to Government disapproval. The Treasury would also have a duty to act reasonably, both in the selection of local authorities liable to higher interest rates and in the determination of those rates. This means that the criteria for charging ahigher rate would have to be defined in a way that was not only unambiguous from the point of view of the PWLB and the local authority, but also clearly justifiable on grounds relating to the security for the loans in question, rather than the identity of the borrower. Finally, the Treasury would not be able to delegate its duties under Section 5 to anyone else, so the scheme could not involve any independent exercise of discretion by the PWLB, in selecting the appropriate rate of interest for a particular loan.

5. The prudential ratios now being developed may offer a suitably objective test of creditworthiness for these purposes. In principle the Treasury might be able to direct the PWLB to apply a higher rate of interest in cases where, for example, an auditor has certified that an authority is in breach of one or more published target prudential ratios. However, it is not yet clear whether the ratios can be developed to provide an analytical satisfactory test of creditworthiness. Nor, until this is resolved, is it possible to say whether a scheme for differential rates can be introduced on the basis of existing legislation: at this stage it seems prudent to assume that new legislation will be needed to put beyond doubt the Treasury's ability to rely on ratio tests of this kind.

6. Legal and technical considerations aside, the case for introducing differential PWLB rates would depend, to a large extent, on the judgement taken about the likely market implications. Here views have changed significantly since the question was last considered in 1981. The central issue is whether the market response would be confined to a deterioration in the terms on which "high risk" authorities could borow, or whether there would be a more general loss of confidence in local authorities, pushing up the cost of funds to even the most creditworthy authorities. In 1981, the Bank of England saw a significant risk of destabilising the whole local authority market. While considerable uncertainty on this issue inevitably remains, the Bank of England

now take the view that, provided it is made clear to the market which local authorities are having to pay higher rates and why, the most likely outcome would be a "tiering" of market rates, leaving rates to those authorities not regarded as "high risk" largely unaffected. Underlying this change of view are marked changes in the market's perception of the extent of central Government's responsibility for local authority debts; a growing sophistication about the differences between local authorities; and a sharp reduction in local authorities' dependence on the market for funds.

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TABLE 1

SPECIAL FUNDS

Unallocated contributions to funds

	£bn
1981-82	+0.2
1982-83	+0.6
1983-84	+0.5
1984-85	+0.2
1985-86	-0.6
1986-87	-0.2
1987-88	-0.4
1988-89	-0.4
1989-90	-0.4
1990-91	-

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TABLE 2

USE OF SPECIAL FUNDS TO AVOID BLOCK GRANT PENALTIES

The example of Nottinghamshire

£m

	1982-83	1983-84	1984-85	1985-86	1986-87
Underlying Expenditure	338	366	376	397	415
Special Funds	28	0	-22	-34	-18
"Total" Expenditure	366	366	354	363	397
Rate Income	-172	-188	-213	-231	-270
Block Grant	-146	-154	-172	-164	-145
Change in Balances	-48	-24	+31	+32	+18
Block Grant Gain from Using Special Funds	-2	0	+49	+85	+9

Total gain £141m

of which £9m from other local authorities through close-ending effects

£132m from HM Treasury through holdback

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TABLE 3

EXAMPLES OF CHANGES TO CAPITALISED HOUSING REPAIRS BETWEEN 1985-86 AND 1986-87 (£m)

	1985-86	1986-87
Camden	23	32
Greenwich	6	23
Hackney	7	12
Hammersmith and Fulham	7	9
Islington	8	11
Lambeth	0	17
Lewisham	10	16
Southwark	13	21
Tower Hamlets	5	12
Wandsworth	15	19
Brent	10	10
Ealing	4	10
Hillingdon	9	14
Newham	9	11
Liverpool	21	15
Newcastle-upon-Tyne	6	10

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TABLE 4

DEFERRED PURCHASE, LEASE/LEASEBACK, ETC:
PLANNED OR REPORTED FACILITIES

	Parallel Loan	Deferred Purchase	Sale/Lease Leaseback	Premia on Interest Rate swaps	Total
Doncaster		£22m			£22m
Dudley		£20m			£20m
Leeds		£70m			£70m
Liverpool		£60m			£60m
Manchester		£130m	£200m		£330m
Rochdale		£10m			£10m
Sheffield		£110m			£110m
Tameside		£10m			£10m
Wakefield		£11m			£11m
Camden	£98m	£11m	£11m	£10m	£130m
Greenwich		£22m			£22m
Hackney		£48		£1m	£49m
Hammersmith and Fulham		£100m			£100m
Islington		£197m	£150m	£20m	£366m
Lambeth		£11m	£7m		£18m
Lewisham		£95m			£95m
Southwark		£42m			£42m
ILEA			£20m		£20m
Brent		£80m	at least	£10m	£90m
Ealing		£100m			£100m
Haringey		£135m	£100m	£29m	£264m
Hounslow		£35m			£35m
Newham		£23m			£23m
Waltham Forest		£41m			£41m
Basildon		£44m			£44m
Brighton		£6m	£46m		£52m
Harlow		£50m			£50m
Leicester		£36m			£36m
Luton		£31m			£31m
Oxford		£20m			£20m
South Buckinghamshire		£2m			£2m
Kingston upon Hull		£5m			£5m
Edinburgh		£104m			£104m
Glasgow		£75m			£75m
Lothian		£49m			£49m
Monklands		£6m			£6m
Total	£98m	£1811m	£534m	£70m	£2513m

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TABLE 5

EFFECTS ON LOCAL AUTHORITY CONTROLS OF MAIN CREATIVE ACCOUNTING DEALS

£m

		assets acquired	spending for control purposes	net gain to LA
1987/88	Current+			
	Capitalised repairs	500	275	225
	Sale and leaseback	0	-75	75
	Special funds	400	0	400
	RCCO for fin. leasing*	0	200	-200
	Total RSG effects	900	400	500
	Capital			
	Deferred purchase	600	0	600
	Finance leasing	400	0	400
	Total gain to local authorities			1500
1988/89	Current +			
	Capitalised repairs	500	325	175
	Sale and leaseback	0	-75	75
	Special funds	400	0	400
	RCCO for fin. leasing*	0	260	-260
	Total RSG effects	900	510	390
	Capital			
	Deferred purchase	200	0	200
	Finance leasing	100	0	100
	Total gain to local authorities			690
1989/90	Current+			
	Capitalised repairs	500	375	125
	Sale and leaseback	0	-25	25
	Special funds	400	0	400
	RCCO for fin. leasing*	0	240	-240
	Total RSG effects	900	590	310
	Capital			
	Deferred purchase	0	300	-300
	Finance leasing	100	0	100
	Total gain to local authorities			110
1990/91	Current+			
	Capitalised repairs	500	425	75
	Sale and leaseback	0	25	-25
	Special funds	0	0	0
	RCCO for fin. leasing*	0	200	-200
	Total RSG effects	500	650	-150
	Capital			
	Deferred purchase	0	300	-300
	Finance leasing	50	0	50
	Total gain to local authorities			-400

+Total expenditure for block grant purposes

* Revenue contributions to capital outlay (RCCO) score as spending for RSG purposes.

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TABLE 6

MAJOR AUTHORITIES WITH SIGNIFICANT REVENUE FUNDING GAPS

Col (i)	Col (ii)	Col (iii)	Col (iv)	Col (v)	Col (vi)	Col (vii)	Col (viii)	Col (ix)	Col (x)	Col (xi)
			1987/88				1988/89			
Authority	Rate-Capped	GRE	Underlying expenditure	Underlying Income	Funding gap	Col vi as % of col iv	Underlying Expenditure	Underlying Income	Funding Gap	Col x as % of col viii
Basildon	* +	7.967	17	14	3	17.6	22	14	8	36.4
Brent	*	164.354	207	183	24	11.6	228	183	45	19.7
Brighton	*	13.638	20	15	5	25.0	21	15	6	28.6
Camden	* +	100.773	179	136	43	24.0	200	137	63	31.5
Ealing	+	154.588	184	176	8	4.3	200	157	43	21.5
Greenwich	* +	68.411	128	95	33	25.8	135	95	40	29.6
Hackney	* +	110.221	163	128	35	21.5	175	129	46	26.3
Hammersmith and Fulham		74.498	101	86	15	14.9	108	86	22	20
Haringey	* +	132.377	204	156	48	23.5	219	156	63	28.8
ILEA	* +	579.751	1026	950	76	7.4	1080	955	125	11.6
Islington	*	100.125	154	106	48	31.2	166	106	60	36.1
Lambeth	* +	131.489	198	152	46	23.2	212	152	60	28.3
Lewisham	* +	89.955	146	116	30	20.5	166	116	50	30.1
Liverpool	+	266.760	332	306	26	7.8	353	308	45	12.7
Manchester	+	276.684	401	316	85	21.2	422	317	105	24.9
Newham	*	154.229	184	168	16	8.7	195	168	27	13.9
Sheffield	*	241.036	316	269	47	14.9	344	269	75	21.8
Southwark	* +	112.227	159	134	25	15.7	179	134	45	25.1
Tower Hamlets	* +	101.651	141	124	17	12.1	150	124	26	17.3
Waltham Forest	+	122.480	155	152	3.	1.9	170	142	28	16.5
TOTAL		3003.204	4415	3782	633	14.3	4745	3763	982	20.7

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NOTES TO TABLE 6

Col ii: * rate-capped in 1987/88
+ rate-capped in 1988/89

Col iv: underlying expenditure represents net committed spending adjusted for anticipated extra income (eg from fees and charges) and unallocated savings but without taking account of financial devices.

Col v: underlying income is broadly equivalent to the expenditure which can be funded from rates and block grant. For rate-limited authorities it is the Expenditure Level set under the 1984 Rates Act or by formula in the 1987 Local Government Finance Act.

Col vi: Col iv - Col v

Col viii: Col iv rolled forward in line with recent trends

Col ix: 1987/88 underlying income (col v), or provisional expenditure levels for rate-capped authorities.

Col x : Col viii - Col ix

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TABLE 7

PRUDENTIAL RATIOS

Interim Examples of ratio figuring - 1985/6

		Oldham MB	Cheshire CC	£m Winchester DC
INCOME	= Rates, Collected	101.9	365.0	9.7
less	Parish, etc precepts			
plus	Block grant,			
	(Rents less standard rebates)			
	Trading surplus*			
	Interest on balances			
DEBT	= Temporary & long term external borrowing (creative accounting liabilities to be added)	224.1	66.4	29.1
RATIO 1985/6	= DEBT % INCOME	220	18	301

Earlier Years Ratios

1984/5	231	22	383
1983/4	210	18	313
1982/3	188	20	384

* Gross Trading Income to be substituted

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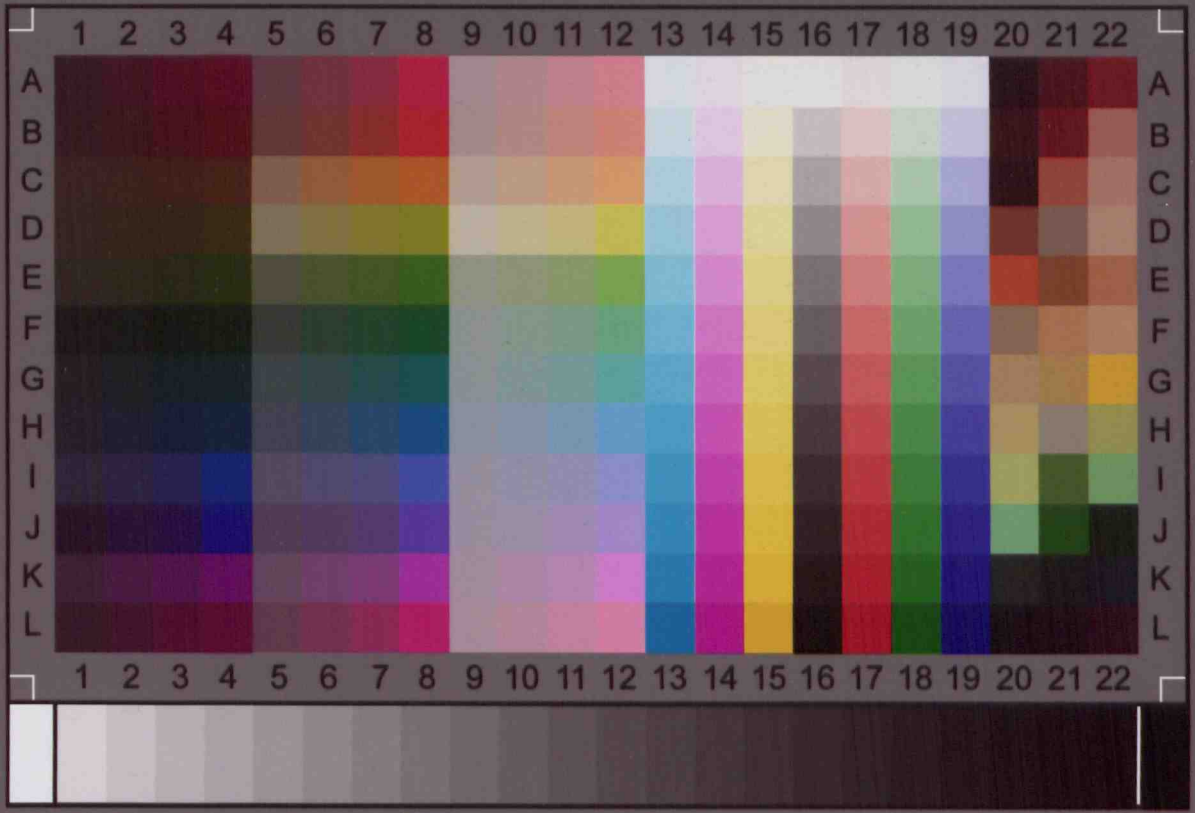
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