



cc No
Prime Minister (4)

MUS 12/7

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Patrick Jenkin MP
Secretary of State
Department of the Environment
2 Marsham Street
London SW1P 3EB

12 July 1983

Dear Secretary of State,
RATE LIMITATION LEGISLATION .

Thank you for sending me a copy of your minute to the Prime Minister of 29 June. I agree with many of the points you make, and should just like to raise a few questions for clarification.

Choice of selective scheme

For the selective scheme, you put forward a new option which was not included in the earlier papers for MISC 79 or E(LF). This would be to give selected authorities a formula-based expenditure target; to invite applications for derogations; and to set rate limits for the selected authorities so that:

$$\text{rate limits} = \text{expenditure target} - \text{grant},$$

with or without allowance for borrowing to run down balances.

This strikes me as an ingenious suggestion, which has at least three advantages. It could ensure consistency between the rules for expenditure, grant and rates. It would put the onus on authorities seeking derogations to bring forward their own evidence. It could make the selective scheme more like the general scheme, and therefore make it easier to manage the transition from one to the other.

But before we commit ourselves to an option of this sort, I should like to be clearer about the relationship between the expenditure targets, which would determine the rates limits, and the existing expenditure targets, which determine holdback of grant for over-spending. This is touched on in the paper by officials which you circulated. I imagine there are three main possibilities:-

- a. We could use the same expenditure targets for determining rate limits as for determining holdback. But there would be risks in this. At present we can, if we want to, set very tight targets for some authorities, because they are not absolutely binding. If they were used to determine binding rate limits, it is arguable that some, at least, might have to be somewhat less tight. I am naturally concerned that this could lead to an increase in the generality of targets used to determine holdback, which are set to be consistent with the provision in the public expenditure white paper for local authority relevant current spending. I am sure that none of us would want to weaken in this way the pressure on the majority of local authorities.
- b. Expenditure targets used to determine rate limits could displace altogether the targets used to determine holdback. We could simply drop holdback. But again, this could mean that we would reduce the pressure on the majority of local authorities. The only major restraint on them would be the threat of a general limit on rate increases.
- c. The expenditure targets used to determine rate limits could be avowedly different from - and probably higher than - the targets used to determine holdback. We might justify this on the ground that the targets used to determine rate limits would be more nearly binding than those which determine holdback. If local authorities choose to spend more than their existing targets, they will remain free to do so. But they will not remain free to do so to the point where rates go through the roof.

I am not clear which of these options you propose to adopt. I have no settled view myself. But my starting point is that the new rate limits should supplement our existing pressures on expenditure, and not substitute for them. My inclination, therefore, is that if we are to adopt the new approach you suggest, we might well have to adopt course c. above. I should be grateful for your advice on whether this would be sustainable. If it would not, I am not sure that we should close, in your white paper, the option of framing the selective scheme in the terms considered earlier by MISC 79 and E(LF).

Choice of general scheme

For the general scheme, you suggest again that:-

Rate limits = expenditure target - grant,

with or without an allowance for borrowing to refinance balances. In this case, the paper by your officials says explicitly that holdback would be superfluous. I have two comments.

First, while the formula you suggest would be logical and consistent, it would make rate limits the residual of the system. As you say in your minute, rate increases would be controlled indirectly. If targets are distributed on one basis and grant on another, roughly as now, the difference between the two could be a pretty random number. As you say, the resulting rate limits could be quite different for different authorities. As a newcomer to the subject, it is not obvious to me that this would be better than a simple reassurance for ratepayers (your model one) that rates should not rise in any one year by more than x per cent, or by x per cent for one class of authorities and y per cent for another. I believe that that is how many will have interpreted our manifesto commitment.

Second, I am not convinced that a general scheme for limiting rate increases will necessarily make holdback superfluous. I have an open mind. But I think Tom King argued, on occasion, that some local authorities might spend up to a rate limit, regarding it as a norm as well as a ceiling. If this risk exists, I am not clear how you would propose to deter them. It could be, in these circumstances, that we should do well to maintain targets and hold-back, to keep a constraint directly on expenditure. At any rate, I should be unwilling to close that option unless and until we are sure that the alternatives are sufficiently robust.

Borrowing and accounting conventions

This leads me to a few more general observations.

First, none of us wants to limit rates and grant only to see a surge in borrowing to finance extra spending. I entirely agree that we should take powers enabling us to take account of balances, if we so wish, in setting limits on rate increases. It is conceivable that we might want to impose stipulations about borrowing and the use of balances on at least some authorities subject to control.

It seems to me that some direct constraint on expenditure, of the kind given by targets and holdback, might also be helpful in this context. If we limit rates and grant, and keep an independent pressure on expenditure, that should in principle imply some restraint on borrowing, as the only remaining variable in the system.

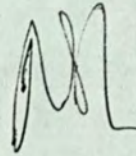
One trouble with this is that it is not always intuitively obvious what counts as expenditure. The picture is complicated, for example, by the use of special funds. I rather suspect that it will be difficult to operate any of our systems fairly without a much greater harmonisation of accounting conventions than there is now. I understand that, on the capital side, we now have statutory definitions of prescribed expenditure. I do not know whether we need go that far for current expenditure. But my first impression is that we badly need not only a standardised form of accounts but also some detailed central guidance on accounting conventions, especially in relation to the use of balances and special funds. This would also help us with the monitoring of local authority

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spending and borrowing, to which I attach importance. It would be helpful to know how you see this fitting into the work on the rates white paper.

I am sending copies of this letter to the Prime Minister and the colleagues who had your minute.

yours sincerely



for PETER REES
(approved by the Chief Secretary &
signed in his absence).

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COVAZ GOVT
Rakhye Keralakatsa
KZ



22 JUL 1985