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O. Letwin.

10 DOWNING STREET

From the Private Secretary

31 May 1984

Rate Limitation: Selection Criteria and Setting of Expenditure Levels

The Prime Minister has seen the outcome of the discussion at E(LA). She is concerned at the use of criteria which will bring councils such as Sheffield, Merseyside and Brent into the scope of rate limitation when they are likely to produce very high rate increases. Although there are perfectly sound technical reasons why rates can rise sharply, even for rate capped councils, these may prove very difficult to get across to the public and, as a result, the policy may be discredited. It might be better to use criteria which exclude such councils in the first year.

The Prime Minister would be grateful if officials could look again at the criteria and the setting of expenditure levels to see if this problem can be avoided.

I am copying this letter to Private Secretaries to other members of E(LA) and to Richard Hatfield (Cabinet Office).

Andrew Turnbull

John Ballard, Esq.,
Department of the Environment.

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1) Mr Turnbull 2) Prime Minister (1)
Agree to ask E(LA) to consider these points further?
DWB 30/5

MR BARCLAY 30 May 1984

RATE-CAPPING

You will have seen the minutes of E(LA)'s meeting on 24 May.

The prolonged discussion of local authority expenditure provision for 1985/86 settled some points quite sensibly and left others to be investigated by officials. There is no need for the Prime Minister to intervene in this.

But the discussion on rate-capping appears to have been much less satisfactory. As the minutes stand, the sub-committee has sanctioned a near-absurdity.

Under the proposed 'solution', Brent, Sheffield and Merseyside will be rate-capped in 1985/86; but their rates will rise sharply. There are perfectly respectable technical reasons for this anomaly, which are explained in the Annex to this minute. But no matter how respectable the reasons, it will be impossible to persuade the electorate that we are sane if the result of our rate capping policy is to bring about sharp rate increases. Any Minister who is sufficiently foolhardy to attempt a complicated explanation of such results on a TV programme will be torn to shreds by an Opposition spokesman who will simply ask: "Is it or is it not the case that rates have shot up in some rate capped authorities?".

Couldn't the Committee consider ways of avoiding such an outcome? One way is to choose different authorities for rate-capping. Another way is to adjust the formula for calculating holdback of grant to give these authorities extra cash from general taxation. Neither of these options is attractive because high spending councils that have been fiddling the books would either escape rate-capping or get extra grant. However, the present solution is even worse, since it threatens to make a laughing-stock of our entire rates policy. The answer is to recoup our losses by being tough on the GLC and ILEA, as the Chief Secretary suggests.

We recommend that the Prime Minister should authorise Andrew Turnbull to write to Lord Whitelaw, as the Chairman of E(LA), expressing her concern.

Agreed MT

Oliver Letwin

OLIVER LETWIN

JMFAAA

ANNEX

RATE-CAPPING AND RATE RISES: REASONS FOR THE ANOMOLY

1. Certain authorities, such as Brent, Sheffield and Merseyside, have engaged in a clever piece of accounting.

2. In the years preceding 1984/85, these councils have transferred money from their "rate fund" to a "special fund" and held it there without spending it. At the time of transfer, this money counts as expenditure, and makes the authority liable to central government penalties. But these penalties will not be draconian if the authority's expenditure is reasonably close to target in the relevant year.

3. During 1984/85, the authorities plan to transfer the money in their "special funds" to their "rate funds". Such a transfer counts as a "receipt", and is regarded as negative public expenditure. As a result, the authorities will appear to have low budgets in 1984/85.

4. Since the target for an authority in any given year is related to its budget in the preceding year, the targets for these authorities in 1985/86 will be artificially depressed by their low budgets in 1984/85. But their apparent "expenditure" in 1985/86 will be vastly increased because they will have no more money in their "special funds" to transfer into their "rate fund".

5. As a result, these authorities will be classed as spending vastly over their targets in 1985/86, and they will therefore be subject to considerable grant holdback. Because of this holdback, they will have to fund a larger proportion of their spending out of their rates; and their rates will rise accordingly.

6. The fact that these authorities will be rate-capped cannot substantially affect the situation. The expenditure limit imposed in the rate-capping exercise must be attainable: otherwise, the Secretary of State will not be able to defend it in court. This means that the limit will have to be set not in relation to these authority's artificially low budgets in 1984/85, but rather in relation to their spending needs in 1985/86. It will therefore be necessary to give them derogations from the general principles of rate-capping, and to allow them expenditure limits far in excess of the target which will have been set in relation to their 1984/85 budget. Therefore, despite these limits, they will be spending well in excess of target, and will be subject to the holdback that causes cause high rate increases.

7. In other words, the "capping" of these authority's rates will not - in any popular conception of the term - in fact cap their rates.

JMFAAB