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PRIME MINISTER

18 June 1985

LIVERPOOL

Patrick Jenkin has been doing well in the rate-capping campaign because he has done nothing. The nerves of the rebel councillors have given way under the strain. Even Lambeth - the last of the rate-capped authorities - will almost certainly give way in early July. Any ham-fisted government intervention in Liverpool might give Lambeth new hope and put the rate-capping success in jeopardy.

So the principal message is: do not panic now. Ministers should stick to the policy they agreed in MISC 109 long ago.

Liverpool Finances

Leaving aside expenditure funded by specific grants and charges, Liverpool plans to spend £117 million more than it receives in rates and block grant.

<u>Expenditure</u>	£ million
BUDGET (expenditure 'relevant' to block grant)	265
<u>Income</u>	
<u>Rate set for 1985/6 for city purposes (excluding Merseyside precept)</u>	125
 <u>Block Grant</u>	 29
LESS:	
<u>Deficit carried over from 1984/5</u>	(6)
 NET 'RELEVANT' INCOME	 148
 DEFICIT	 <u>117</u>

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The deficit of £117 million may look horrifying; but it will not occur suddenly. Each month, Liverpool receives an instalment of block grant, and an instalment of rates. The City's cash flow therefore looks roughly like this:

£ million: rough estimates

	<u>April</u>	<u>May</u>	<u>June</u>	<u>July</u>	<u>Aug</u>	<u>Sept</u>
<u>Monthly 'Relevant'</u>						
<u>Expenditure</u>	22	22	22	22	22	22
<u>Monthly 'Relevant'</u>						
<u>Income:</u>						
Block Grant	6	6	6	6	6	-*
Rates	<u>10**</u>	<u>10</u>	<u>-</u>	<u>5</u>	<u>10</u>	<u>10</u>
Total	16	16	6	11	16	10
<u>NET MONTHLY</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<u>DEFICIT</u>	<u>6</u>	<u>6</u>	<u>16</u>	<u>11</u>	<u>6</u>	<u>12</u>

NB

* By mid-August, Liverpool will have used up its entire block grant entitlement.

** Rates for 1984/5 were still being paid in April and May; rates for 1985/6 will probably start to come in during July, with higher rate flows later in the year.

As you can see from the table, the monthly deficits until September are not so huge. They could be funded by the City Treasurer in at least four ways:

1. Delaying various 'relevant' spending items until later in the year - there is usually more room for such manoeuvres than the pessimists believe.

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2. Temporarily diverting specific grants and fees/charges to cover the deficits in the early months - this, too, should be possible.
3. Borrowing short-term from other sympathetic councils, such as the GLC, Sheffield, Newcastle - risky, but likely to be exploited.
4. Spending slightly below budget - we do not know how far the budget is a propaganda exercise rather than an actual plan for spending: there may be a lower, 'hidden budget'.

For all these reasons, we do not believe that Liverpool is likely to go bust before the autumn, unless they have a major need for refinancing of debt in the intervening months. There will probably be a need for such refinancing in the near future; but it is not clear when this will arise, or how large the problem will be.

We believe that there is a real chance that Liverpool will still be up and running for at least another two or three months. And even if there is financial trouble, the City has shown that it will be quite capable of treating Liverpool differently from the rest of the Government debt market: there is no reason to fear a general collapse of confidence.

Political Strategy

Derek Hatton is undoubtedly engaged in a war of nerves.

If he holds out until September, the City auditors will have completed the initial stages of the surcharge and disqualification proceedings. The councillors could then accept disqualification, and cause by-elections in October, just as the finances are breaking down; or they might find a

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way of keeping the books in balance for yet longer, while they appeal against disqualification.

Whatever the outcome, Hatton's aim is to stretch your nerves to breaking-point. If you allow Patrick either to negotiate about cash handouts, or to send in the Attorney General, with writs firing on all sides, Hatton will think that he has you on the run.

Given that there is little prospect of immediate financial collapse, the best course is, surely, to take no Government action for the present, but rather to find some local ratepayer who will take the council to court and get the illegal rate quashed. Couldn't Central Office identify such a person? (Failing that, we have one or two ideas of our own).

Besides being much less heavy-handed, a local ratepayer is (paradoxically) much more difficult for the council to resist. If the Attorney General has a writ issued, the council can refuse to comply, and play 'David facing Goliath'; this would not be possible with a local ratepayer.

Conclusion

We recommend that you should:

1. resist pressure for any Government action at this stage;
2. ask Central Office to stimulate a local ratepayer to start legal proceedings.

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