Subject

File

JR

CONFIDENTIAL CMO

cc Master

bc: Mr. Redwood
Mr Buckley CO

10 DOWNING STREET

From the Private Secretary

26 April 1984

Dear John,

LIVERPOOL

The Prime Minister held a meeting today to discuss developments in Liverpool. Present were the Home Secretary, the Lord Privy Seal, the Secretaries of State for the Environment, Education, Defence, Trade and Industry, and Social Services, the Chief Secretary and the Attorney General. Also present were Sir Robert Amrstrong and Mr. Buckley of the Cabinet Office. The meeting had before it your Secretary of State's minute of 25 April.

Your Secretary of State reported on the meeting of the Liverpool City Council the previous day. Each Party had put forward its own proposals and each in turn had been voted down. In the absence of any co-operation between the Parties, no budget and no rate were settled. The next event would be the local elections on 3 May at which the Labour Party were expected to increase their majority with the likelihood that they would then be able to pass their proposals.

Your Secretary of State said there had been confidential discussions between his Department, the Treasury, the Bank of England, the Director of CIPFA, Mr. Hepworth, and Mr. Stonefrost of the GLC, on the implications for local authority financial markets of a default by Liverpool. Liverpool had to re-finance £130 million debt by mid-June, with £20 million of bills needing to be re-financed by 23 May. Total local authority non-PWLB debt amounted to around £17 billion, of which £4 billion was short term. There could be a hiatus affecting all authorities which would then have to turn to central Government. An interruption of one month could require extra central Government borrowing of £1 billion to hold £M3 on course. The average cost of local authority borrowing could rise, each extra 1 per cent adding £400 million to public expenditure. Your Secretary of State said it had previously been accepted that the introduction of Commissioners should be delayed until a crisis in the provision of services had occurred, when residents of Liverpool would themselves welcome Commissioners as a way of restoring order. There were two responses to the emergence of difficulties in local authority markets generally. The Government could issue

/ a statement DSG

a statement of reassurance, falling short of a guarantee, indicating that the difficulties were confined to Liverpool and that other authorities remained sound credit risks. There were doubts, however, about whether this would suffice. Alternatively, the Government could announce the circumstances in which it would be prepared to introduce Commissioner legislation. This would involve an amendment to the draft Bill which related the introduction of Commissioners to action which "prejudiced the interests of inhabitants of that area" rather than to difficulties in local authority finance markets generally.

In discussion, a number of arguments were raised against announcing an intention to legislate for Commissioners in this way. First, it would conflict with the view taken hitherto that for Commissioners to be acceptable to Parliament and in Liverpool, their introduction would have to be delayed until it was manifestly needed to restore a collapse in services. Secondly, doubts were expressed as to whether the consequences for local authority finance markets would be as dire as predicted. While there could be a temporary disruption, the market would subsequently adjust. While there would be more differentiation between authorities it was unlikely that banks and institutions would cease lending to sound authorities. Finally, a substantial redraft of the Bill would be required.

The Chief Secretary asked whether a special audit could be sought, either by a ratepayer or the Secretary of State, to establish the assets and liabilities of Liverpool. Your Secretary of State said he had offered a special audit, under the auspices of the Audit Commission into the efficiency of services in Liverpool. But it was doubtful whether the assets and liabilities of the City could quickly be established as no public authority maintained a balance sheet.

Summing up this part of the discussion, the Prime Minister said the meeting did not favour announcing an intention to introduce Commissioners in response to difficulties in local authority finance markets. It was yet to be established how serious these difficulties would be and this course could cause Commissioners to be introduced before the conditions for their acceptance in Parliament and Liverpool had emerged.

The meeting then turned to the question of whether, after the local elections, the Attorney General should take legal action to prevent an inadequate rate. The Attorney General explained that, with two attempts to establish an illegal rate having been made, there was sufficient basis on which to seek an injunction in the courts. He could, in addition, also seek an order of mandamus to require a legal rate to be made, though this would present greater difficulties. If he were to take action, and he did not personally favour it, it would have to be before the Council met to make an inadequate rate. Once set, such a rate could not at present be altered as the 1982 Act forbade the introduction of substitute rates.

/ In discussion

In discussion it was noted that two distinct courses of action were open to the Government; pre-emptive legal action to prevent an illegal rate, or allowing events to take their course, leading ultimately to the question of Commissioners. Against the former course, it was argued that the Government would become involved at a much earlier stage before its intervention would be welcomed. If, however, events were allowed to unfold, the Government could be open to criticism if it could not demonstrate that it had provided adequate warning of the consequences. It was noted that many warnings had been given, by the Attorney General in a PQ, by the Secretary of State for the Environment and by the Council's own offices.

An alternative to this would be to allow the District Auditor to seek to have the rate declared inadequate and hence illegal, and to impose penalties on the Councillors responsible. For this to happen, it might be necessary for the Government to state that it would amend the 1982 Act to allow a new rate to be set.

In further discussion it was noted that the introduction of Commissioners, while being an onerous task for the Government as well as politically dangerous, was also an opportunity to tackle some of Liverpool's longstanding problems. If this opportunity was to be taken, it was important to choose people as Commissioners with the right qualities of leadership. Your Secretary of State said he was preparing a paper on how Commissioners might be introduced and how they might operate and he would circulate this to colleagues shortly.

Summing up, the Prime Minister said the meeting did not favour legal action by the Attorney General. Further consideration should be given to the consequences of action by the District Auditor to declare Liverpool's rate inadequate. The group should meet again shortly after the local elections to consider developments.

I am copying this letter to the Private Secretaries to those present at the meeting, to David Peretz (HM Treasury) and to Richard Hatfield (Cabinet Office).

Yours sincerely
Andrew Turnbull

(ANDREW TURNBULL)

John Ballard, Esq.,
Department of the Environment.

Subject

cc Master

MINUTE OF 26 APRIL'S MEETING OF THE PRIME MINISTER'S GROUP ON LIVERPOOL

For the record the following points were not quite right:

PAGE 2, PARA 1: Amendment of Commissioner Bill. If the Commissioner Bill was to be used where default in Liverpool created a general problem of local authority creditworthiness we might have to amend the criteria for appointment of a commissioner to include a failure by the local authority to meet its financial obligations in a way likely to prejudice the interest of local inhabitants. The Bill as presently drafted is useable only when actual harm has been done to local inhabitants, and this is unlikely to follow immediately on default.

PAGE 2, PARA 3: Audit Commission Study. The Secretary of State proposed to Liverpool Council that they seek a study by the Audit Commission of their efficiency, effectiveness and economy. This would be forward-looking unlike an audit which is a backward look at expenditure.

PAGE 2, PARA 5: Substitute Rates. The Local Government Finance Act 1982 does allow the making of substitute rates at the same level, or lower, than a rate which is quashed. What it does not allow is a supplementary higher rate to be made. If a rate were quashed because it was inadequate and a substitute one made, the authority concerned would have to reduce its expenditure or increase rents, fees and charges to balance the books (though there must be a question mark over the practicality of this approach).

PAGE 3, PARA 2: Role of the Auditor. The Auditor cannot challenge the validity of a rate. He is concerned with expenditure, here the expenditure consequences of failure to make an adequate rate.

- 8 MAY 1984

PRIME MINISTER

LIVERPOOL CITY COUNCIL: CREDITWORTHINESS

1. In my minute to you of 16 April I promised an urgent report on the creditworthiness of local authorities in the light of events in Liverpool. This minute records the outcome of a discussion I had with the Chancellor on 18 April.

The Problem

2. At the moment the market for lending to local authorities generally is still working; Liverpool itself has recently been lent money by the Public Works Loan Board. But it would probably have difficulty if it sought funds from the private sector. We now know that it has to refinance £130 million of debt by mid-June. If an illegal rate is set, it will not be able to borrow even from the PWLB. So there is now a substantial risk of default, which Treasury and the Bank believe could seriously affect the market for all local authorities. There could be a period in which no local authority was able to borrow, followed by the development of differential interest rates and a permanent upward shift of rates for all authorities. Local authority non-PWLB debt amounts to some £17 billion, £4 billion of which is short-term money. Accordingly, any such development might have a damaging impact on our monetary and public expenditure strategy. It is therefore essential that we lay contingency plans to reassure the market against the risk of default.

3. We cannot be sure when such a default might occur. The City Treasurer, we understand, does not need to go to the market to borrow or refinance debt until mid or late May. Some concern may be shown by the market, however, should Liverpool fail to make a legal rate today or should the election on 3 May result in an increased Labour majority.

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Solutions

4. The Chancellor and I are strongly opposed to any solution which would effectively provide a central Government guarantee for local authority debt (even if such a guarantee were secured against future revenues of the authority concerned). The only options we have identified which might be adequate to reassure the market once it becomes seriously concerned about lending to local authorities generally and would avoid effectively giving such a guarantee are:

i. to issue a reassuring statement, on the lines previously discussed, pointing out that Liverpool has put itself in a unique position; that the credit of all other authorities is as sound as it has always been; that the PWLB stand ready to lend to all other authorities (perhaps coupled with announcement of a new 3-month facility); and that the Government will take appropriate action if it should become necessary;

ii. to announce the circumstances in which we would introduce Commissioner legislation. There are three distinct stages: the announcement of the intention to legislate, the introduction of legislation and the appointment of Commissioners to Liverpool. It may be possible to move step by step as the markets need further reassurance and as the situation in Liverpool deteriorates.

5. A general statement of reassurance, without mentioning Commissioners, might help if the markets became unsettled in the period before default. But if default once occurs, we are very doubtful whether such a statement would have the desired effect. It might even serve to heighten concern in that the market would want to know precisely what the Government intended to do.

SECRETARY OF STATE FOR THE ENVIRONMENT

6. It is the Chancellor's view that an announcement of the circumstances in which we would legislate for commissioners would be the minimum necessary to reassure the market if default had taken place. It is hoped that the market might then live with a delay of some weeks before outstanding sums were paid, unprecedented though this would be, and other authorities would be only marginally affected.

7. I do not dispute the Chancellor's assessment. But we must be very clear that an announcement of intent in advance of an actual breakdown in services does not accord with our current strategy that no action on Commissioners should be taken until there is a clear need to protect the interests of local people. An early announcement would have the following disadvantages:

a. We could not be certain that an announcement of our intention to legislate would be enough to reassure the market. Indeed such an announcement could undermine market confidence in Liverpool and hasten the City's collapse, for which the Government would be blamed.

b. It would weaken the Government's political stance. Parliamentary handling of the Commissioners Bill would be more difficult if it was a response to a general problem of local authority credit rather than a self-evident crisis in Liverpool. We would give the City Council a greater opportunity to make propaganda out of the dismissal of democratically elected councillors.

c. The people of Liverpool would find it much less easy to understand why Commissioners were necessary; the subsequent administrative efforts of the Commissioners would be more likely to secure support from local citizens and staff if viewed against actual experience of a breakdown of services.

d. If breakdown of services had not actually occurred, we would have to amend the Bill as presently drafted to allow its use when the actions of an authority led to the expectation of harm being done to local people. This would widen the criteria considerably.

e. There is some risk once the precedent of early Government action was set of encouraging other authorities, individually or collectively, to follow Liverpool's lead (particularly those subject to rate limitation). This would be less likely if Commissioners succeeded in demonstrating that they were coping with the Liverpool situation satisfactorily and without causing any serious problems for the Government; but we have to acknowledge that Commissioners might encounter severe obstruction which would make it difficult for them to be seen to be running a smooth administrative machine.

CONCLUSION

8. We face a difficult task in balancing the need to protect local authority credit in general and to maintain our original strategy of using Commissioners in Liverpool as the very last resort. If a default by the City Council, leading to general problems of creditworthiness, is followed very rapidly by a collapse of services in Liverpool, the basis on which we have hitherto been proceeding can be maintained (ie that Commissioners would not be put in until there was a clear local emergency leading to a need for such action). It is, however, much more likely that there will be an interval of a few weeks at least between any evidence emerging of a general problem of local authority credit (not necessarily occurring first in Liverpool itself) and the breakdown of Liverpool's services. We need, therefore, to make our response to the situation as flexible as possible.

9. As a first step we must stand ready to make a reassuring statement (on the lines described in paragraph 4(i) above) about the creditworthiness of local authorities generally at the point when the Treasury and Bank judge it to be needed. But since

it will inevitably provoke comment and speculation, I hope that it can be held back as long as possible.

10. My understanding of the Chancellor's position is that he does not believe it will be necessary to make an announcement of Commissioner legislation until Liverpool defaults. Once default has taken place, and if that has the effect on the market which the Bank and Treasury fear, I see no alternative but to announce that we are prepared to legislate. If this statement is insufficient to reassure the market, we could have to move quickly first to introduction, then to use, of the Bill, amended as appropriate. We would only move at each stage on the advice of the Chancellor and the Bank of England as to the state of the market. We would not wish to put in Commissioners before the collapse of council services in Liverpool unless there is clear evidence that this is essential to safeguard local authority creditworthiness generally.

11. We shall in any event need to prepare an alternative, contingent version of the Bill to allow the appointment of Commissioners where there was the expectation of harm being done to local inhabitents. This is not a major task.

LEGAL ACTION

12. I should raise one further issue. We will wish to consider urgently in the light of today's events and of the elections on 3 May whether it would be right for the Attorney General to take action against the City Council if they make an illegal rate or fail to rate at all. My own view is that, in these circumstances, early action by the Attorney would be desirable.

13. I suggest that we discuss this minute when we meet tomorrow. I will then be able to report on the outcome of the City Council's meeting today and on any market reaction if the Council have failed again to strike a legal rate.

SECRETARY OF STATE FOR THE ENVIRONMENT

14. I am sending copies of this minute to Leon Brittan, Nigel Lawson, Keith Joseph, Michael Heseltine, Norman Fowler, Norman Tebbit, Peter Rees, Michael Havers, Sir Robert Armstrong and Mr Buckley (Cabinet Office).

P.J.

P J
25 April 1984