



CONFIDENTIAL

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PRIME MINISTER

Liverpool City Council: Possible S.78 Direction

BACKGROUND

The latest City Treasurer's report provides more evidence that Liverpool's 1985/86 capital expenditure is likely to exceed, perhaps by as much as £32 million, the resources available to it (block allocations plus use of available capital receipts) under the Local Government Act 1980. Section 78 of the Act provides that, in such circumstances, the Secretary of State may issue a direction barring the Council from incurring expenditure which would take it over the statutory limits and from entering into new capital commitments (over a size to be specified) without his permission. Once such a direction has been made, spending on letting of contracts in defiance of it would be ultra vires, and wilful loss arising from such action could lead to legal action and the surcharge and disqualification of the councillors responsible.

2. The consequences of action might be far-reaching. Treasury officials have advised that any ultra vires action by Liverpool would prevent the Public Works Loans Board (PWLB) from lending, even if it did not of itself jeopardise the security of the PWLB loan. (The Department of the Environment are less convinced; Mr Jenkin should be able to report on the latest position). This might precipitate a financial collapse, leading to a need to activate the existing contingency plans, including Commissioners.

Proposals

3. Mr Jenkin's letter of 5 February to the Chief Secretary proposes:





- a. sending Liverpool a warning letter to coincide with his visit on 7/8 February;
- b. allowing 14 days for representations, with the implication that a direction would then be made if the Council response was unsatisfactory;
- c. once a direction has been issued, taking a tough line on consents for new capital expenditure;
- d. action within Government to minimise the imposition of fresh requirements on Liverpool for capital expenditure in 1985/86.

## MAIN ISSUES

4. The main issues are:
  - i. whether to embark now on a course which could lead to the issue of a S.78 direction;
  - ii. the Government's stance once a direction has been issued.

S.78 Direction

5. The immediate question is whether or not to make formal inquiries about the Council's position. If a letter along the lines of the draft attached to Mr Jenkin's letter of 5 February is sent, he will be legally bound to consider Liverpool's response before deciding whether or not to issue a direction. It is just possible that the Council will be able to suggest ways in which their capital programme can be legally financed, in which case no direction could be issued. It is more likely that the Council's response will be unsatisfactory. Mr Jenkin would then have little option but to proceed with a direction. It follows that if Ministers are not prepared to institute a direction and





follow through the consequences, the process of formal inquiry should not be initiated.

6. Ministers will wish to balance the disadvantages of pursuing the direction route:

- it will lead to accusations that the Government is deliberately provoking a financial collapse;
- the direction could have adverse effects on Liverpool's, and perhaps other local authorities' creditworthiness;
- it will be difficult to present given Liverpool's housing problems;
- the powers have not been used before, and there must be some worries about their effectiveness;
- the direction would not necessarily bring Liverpool's capital spending quickly under control. Existing contracts would still be legal. Some new contracts could be required to meet other statutory obligations (see paragraph 9 below);
- if a collapse did result, the timing would be uncertain. It might be some months into 1985/86 before expenditure clearly exceeded resources. If the Council let contracts without consent, this would be a clear breach, but enforcement would rely on legal action by a ratepayer, councillor or the Attorney General;

against the advantages:

- Although they have never been used the S.78 powers are a normal part of existing legislation. If the Government failed either to employ them or even to be seen to consider employing them, this might be taken as indicating a lack of confidence on its part.





This could have an adverse effect not only on the Government's handling of Liverpool, but also on abolition and the rate-capped authorities;

- Mr Jenkin's proposals are consistent with the general strategy, approved at the Group's first meeting, of letting events take their course. Mr Jenkin outlined the possible need for a direction at that meeting (MISC 109(84)1st Meeting);
- Ministers have already accepted that a collapse is probable; it is not clear how a S.78 direction would affect the timing;
- a direction opens the way for a curtailment of excess spending. Liverpool might comply with either the warning or the direction. If not, a collapse should lead eventually to Liverpool's finances being put on a sounder footing;
- the direction need not be the cause of collapse; the Treasurer's report shows a £25 million deficit on revenue in January;
- Government action will be welcome to moderate opinion; there is evidence that the Council is becoming increasingly unpopular.

### Timing

7. Mr Jenkin argues for a decision now, so that he will have a clear position for his visit to Liverpool. The Treasurer's report which would form the basis of his approach is equivocal; although identifying a gap between spending plans and resources it says that ways of bridging the gap are being examined. The Department of the Environment believe it is unlikely that these moves will be successful,





but the Group might consider the case for waiting until the position is clearer; any direction could not take effect before 1 April. On the other hand too long a delay could allow Liverpool to pile up further commitments.

#### Government stance post-direction

8. Mr Jenkin advocates a tough stance on consents for new expenditure. This is likely to mean turning down other-wise desirable projects, eg. on education. There may be scope for some flexibility on a case-by-case basis, but any other general stance would be unlikely to bring spending under control, which would be the justification for making the direction.

9. It is unclear whether a S.78 direction would override other statutory obligations, for example on education expenditure, but there is no need for the Group to resolve this, or other matters of detail now.

#### HANDLING

10. You will wish to ask the Secretary of State for the Environment to explain his proposals. The Chief Secretary might then be asked about the financial implications. Individual Service Ministers will wish to comment on the implications for their services.

#### CONCLUSIONS

11. You will wish to reach conclusions on the following:

- i. whether the Group is prepared to countenance the issue of a S.78 direction;
- ii. if so, whether Mr Jenkin should proceed to early formal inquiries of Liverpool;





iii. the Government's general stance following the issue of a direction.

A handwritten signature in dark ink, consisting of stylized, overlapping letters.

C J S BREARLEY

6 February 1985