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From the Private Secretary

4 July 1988

Dear Roger,

1989-90 RSG SETTLEMENT

The Prime Minister held a meeting earlier today to discuss your Secretary of State's minute of 1 July. Those present were: the Chancellor of the Exchequer, your Secretary of State, the Lord President of the Council, the Secretary of State for Energy, the Chief Secretary to the Treasury, Richard Wilson (Cabinet Office) and Peter Stredder (Policy Unit).

I should be grateful if you and copy recipients would ensure that this document is handled strictly in accordance with the CMO arrangements.

Your Secretary of State said that his minute summarised the conclusions he had reached in agreement with the Chief Secretary. The potential for local authorities to manipulate the Rate Support Grant (RSG) system if it was not quickly closed down were very great; City institutions were active in advising local authorities on possible manipulations, and the Exchequer was at risk to the tune of as much as £2 billion additional grant. Any hint that the Government was considering action to stall further manipulation could, within a matter of hours, lead to action by authorities running into hundreds of millions of pounds; tight security on the present discussions was therefore essential. Against that background he was persuaded that it was essential to make a statement as soon as possible, including an announcement of the amount of Exchequer grant to be made available in the 1989/90 RSG settlement. Action to close down the RSG system would require a short Money Bill next session, which would need to complete all its stages by the end of February 1989 so that local authorities were able to draw up their budgets and rates for 1989/90. He recognised that this would be unwelcome, given the pressure on the legislative programme, but such a Bill would be necessary in any event before the introduction of the Community Charge. An announcement on the lines he proposed would certainly be controversial, but your Secretary of State did not anticipate the row would be long lasting or damaging.

In discussion the following points were made:

- (i) it would be essential to check the legal position, in particular to ensure that the planned announcement would not run the risk of judicial review. The Attorney General, who had been sent the papers, should be asked to consider this aspect. The main potential sources of concern were the absence of prior consultation with local authorities, making the legislation retrospective to the date of the announcement and closing off the scope for local authorities to making supplementary claims for grant in respect of 1987-88 and 1988-89;
- (ii) consideration should be given to who would be the gainers and losers from the proposed change. A key point here was that, if action was not taken, the main gainers would be those authorities who had been most actively engaged in creative accounting devices. There was potential for some authorities to make massive gains in relation to past years. If no statement was made on the future of the RSG system by the time the capital control consultation document was issued, authorities would be given a clear incentive to embark on manipulation of the system;
- (iii) a possible drawback with the proposed approach was that, with a fixed grant in 1989/90, the disincentive to overspending would be removed and there would be no grant underclaim as in earlier years. On the other hand, in the absence of close-down, the incentive to authorities to engage in manipulation was in practice likely to lead to an even worse position and a grant overclaim. The only alternative approach would be a much tougher 1989/90 grant settlement, but this would then penalise all authorities for the creative accounting practices adopted by some of them. And it would be those authorities who had previously engaged in creative accounting who would be in the best position to deal with a general squeeze on grant;
- (iv) consideration might be given to earmarking a specified sum within the overall grant settlement as compensation to local authorities for the removal of their right to make supplementary claims for grant. One possibility would be to earmark £75 million for both last year and this year. This approach might help reduce the risk of judicial review. (You subsequently told me that your Secretary of State had now concluded that there would be legal and practical difficulties with this earmarking approach; and that he now felt it would be more appropriate to make a general statement in the settlement announcement indicating that it was more generous than would have been possible if the RSG system had not been closed down.)

- (v) the impact of the proposed change on the introduction of the Community Charge in 1990/91 should be considered. In general this factor favoured the proposed approach; without action to close down the RSG system authorities would have an incentive to run down their balances and set low rates in 1989/90, and then to introduce relatively high community charges in 1990/91;
- (vi) it was necessary to check whether the proposed legislation would indeed be a Money Bill. The key consideration was whether this was primarily a Bill involved with the Exchequer paying out grant, or whether it had a more general purpose relating to local authorities;
- (vii) the proposed Bill was most unwelcome in terms of the pressure on the legislative programme for 1989/90. Several other Bills required a "fast track" during the early part of the year. On the other hand, it was arguable that, if no early action was taken, subsequent action necessary to block off a wide range of loopholes exploited by local authorities would in the event lead to more Parliamentary time being taken up in 1989/90. One possibility which might be considered would be whether the proposed Money Bill could be handled in the Parliamentary overspill period although this too would have risks for the rest of the programme;
- (viii) the issues under consideration would need to be brought to E(LA). Your Secretary of State and the Chief Secretary should reach an agreed position on levels of grant and provision for 1989/90 before the E(LA) meeting. One point they would need to take into account was the percentage grant implied;
- (ix) the Secretary of State for Wales had put to the Chief Secretary a proposal that, in order to ensure that rate increases in Wales were not higher than in England, there would need to be additional Exchequer grant in Wales. It was agreed that, if the case for some adjustment in Wales was compelling, it would be appropriate to add a "gesture amount" to grant.

Summing up the discussion, the Prime Minister said that it was agreed that there was a strong case for taking the action proposed by your Secretary of State and the Chief Secretary and for an announcement to be made on 7 July. However, it was essential that, before a final decision was reached, the legal position and the threat of judicial review was thoroughly explored in consultation with the Attorney General; it was also necessary to check that the proposed legislation would be a Money Bill. The Lord President would give further consideration to the possibility of such a Bill being taken in the spillover period. The next step would be for the proposals to be put to E(LA) at a meeting on Wednesday evening. The Secretary of State for Energy would then make an

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oral report to Cabinet on 7 July on the conclusions reached at E(LA).

I am sending copies of this letter to Alex Allan (Treasury), Alison Smith (Lord President's Office), Stephen Haddrill (Department of Energy), Jill Rutter (Chief Secretary's Office) and to Trevor Woolley and Richard Wilson (Cabinet Office).

*Yan,
Pat*

PAUL GRAY

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