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PRIME MINISTER

RATE SUPPORT GRANT SETTLEMENT

As agreed at your meeting on Monday, the Secretary of State for Energy will give an oral report on the position reached. I enclose a draft of his speaking note, which reflects the outcome achieved at this evening's meeting of E(LA), which I attended.

The key points in E(LA) were:

- (i) the "closedown" proposal was quickly agreed with no dissenting voices. Mr. Ridley reported that the Attorney had given the proposal the OK and Parliamentary Counsel had ruled that it would involve a Money Bill;
- (ii) the meeting did not resolve whether the necessary legislation should be taken early in the next session or in the spillover. The Chief Secretary argued that latest advice pointed to some risk of successful legal challenge if the Bill was not handled in the overspill; but the issues here are still being looked into. I understand the Lord President would, other things being equal, prefer not to have it in the spillover;
- (iii) aggregate Exchequer grant for England was fixed - again with scarcely any argument - at £13575 million for 1989/90. This represents a 9% increase on 1988/89, and implies rate increases of 5-7% if spending is at GDP +3%;
- (iv) the Welsh grant figure has been fixed at £1316 million, involving a £5 million "gesture";
- (v) there was considerable argument about fixing the level of provision for 1989/90. The Chief Secretary

revealed that the GDP deflator was now expected to be 4.5% rather than the 4% figure included in the Budget Red Book. This extra ½% implied an extra £140 million for any given real level of provision;

(vi) the argument was on traditional lines with all the local authority service Ministers arguing for more, with the Chief Secretary supported by the neutrals. In the end a provision figure for England of £29140 million was agreed, which implies a call on the Reserve of £1.4 billion. This is actually slightly tighter than the figures being talked about at your meeting on Monday once you allow for the extra ½%. But it clearly involves taking a big slice out of the Reserve;

(vii) Mr. Ridley's rate-capping proposals were agreed.

I also enclose for reference the Attorney's Opinion and Mr. Ridley's draft statement which you saw in the earlier box. It will also be necessary for the Welsh Office (Mr. Roberts in Mr. Walker's absence) to make a statement to the House immediately after Mr. Ridley; the Welsh Office will let us have a draft early tomorrow.

You should have no difficulty obtaining Cabinet endorsement to the package; there were 10 Cabinet members at E(LA) and Mr. Walker (who will still be in Russia tomorrow) has also *been* tied into the deal. Key points on your summing up might be:

- (i) endorse the closedown;
- (ii) remit to business managers and Ministers most concerned to consider further whether the Money Bill should be in the spillover or the next session;
- (iii) endorse figures agreed by E(LA) for aggregate Exchequer grant and provision for 1989/90;

- (iv) endorse 7 general purpose authorities and the ILEA being selected for rate-capping in 1989/90-
- (v) ask Messrs. Ridley and Roberts to make a statement to the House on Thursday afternoon.

RCB

PAUL GRAY

6 July 1988

PM2AAK



HA

10 DOWNING STREET

PRIME MINISTER¹

RSG CHANGES

1 attach:

(A) Attorney-General's views on the legalities. It seems to give the go-ahead. ✓ _{ms}

(B) Draft of ~~the~~ Mr. Ridley's statement for tomorrow (which office draft will follow). _{ms}

1 am attending this evening's E(LA) meeting and will let you have a report and brief take on in the evening for tomorrow's Cabinet.

REC 6

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*With the Compliments of
the Attorney-General*

*Attorney General's Chambers,
Law Officers' Department,
Royal Courts of Justice,
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01-936 6201



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A RCBG

ROYAL COURTS OF JUSTICE
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The Rt. Hon. Nicholas Ridley, AMICE, MP
Secretary of State for the Environment
2 Marsham Street
LONDON SW1P 3EB

6 July 1988

Dear Nicholas,

1989/90 RSG SETTLEMENT

at flap

You copied to me your minute of 1 July to the Prime Minister in connection with the risk that local authorities will seek, by various dubious accounting practices, to maximise their rate support grant entitlement in the final year of the present RSG system.

I have considered carefully the details of your preferred option for closing down the present system. Your basic objective is to secure that the spending assumptions which form the basis for the imminent RSG Report for 1989/90 should also form the basis for any Supplementary Report or calculation of RSG for 1989/90, without the need to update those assumptions by reference to information which subsequently becomes available. Moreover, in the calculation for any earlier year for which there had been no final determination of RSG you would wish to take account of information available to you on or before a chosen cut off date in July 1988. These proposals are to be carried into effect by an early announcement in Parliament of what is proposed, followed by a short Bill which will, in effect, relieve you of any obligation to take account of information which comes to light after the cut-off date.

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Your proposed announcement to Parliament will of course be no more than a statement of intention to change the law, and no such change will be effected until the Bill you propose has received the Royal Assent. It is obviously essential that, during the period between the date of your announcement and the granting of Royal Assent, you and your officials act in accordance with the statutory provisions for the time being in force, albeit that you know that the position will change after Royal Assent. Those local authorities which are hostile to your policy will not be slow to challenge in the Courts any failure to comply with the present law for so long as it remains in force. However, while you are obliged to comply with your existing statutory duties and powers, and may not (for example) select an option which it would not otherwise be appropriate for you to adopt within that framework, you may relevantly take into account the prospect of the enactment of the proposed Bill when you make decisions or exercise discretions in the context of the present RSG system. I understand that your officials have had the advice of Counsel on this point.

Although there will be no question of your making any Supplementary Report or calculation by reference to the proposed cut off date until after the Bill receives Royal Assent, the Bill is retrospective to the limited extent that you will be enabled to leave out of account information arising prior to Royal Assent which you would otherwise have been obliged to take into account. The Law Officers advised in February on an earlier proposal by your Department (in relation to loopholes in the capital control system) to announce new policy and to give the legislation retrospective effect to the date of the announcement. On that occasion we observed that it was constitutionally undesirable to employ this device in circumstances where a long interval was expected to elapse between the announcement and the enactment of the relevant legislation. By way of guidance we suggested that the device should be used only where the policy was to be implemented by a provision in a Bill currently before Parliament at the time of the announcement or which is to be introduced in the same Session. That guidance was not, however, intended as an inflexible rule. It is clear that by

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mid-July in any year there is no realistic possibility of getting a controversial Bill, however short, through all its stages by the end of the current Session. In the present case, despite the fact that the anticipated period of 9 months between the dates of your announcement and of Royal Assent to the proposed Bill is a significant one, I am satisfied that your need to act quickly to pre-empt abuse of the RSG system does justify the modest degree of retrospection that the Bill will involve, particularly as it is your intention to introduce it as early as is practicable in the new Session. I would not therefore wish to raise any objection to it on constitutional grounds.

Following your announcement, there will be complaints from local authorities that there has been no consultation about the changes you have proposed. This is inevitable, because any period of consultation would have afforded to local authorities the opportunity to exploit the very abuses of the system that you are seeking to eliminate. I am satisfied that the absence of consultation can in these circumstances give rise to no significant risk of successful legal challenge, because your announcement will in effect be no more than a statement of your intention to promote primary legislation. It is nevertheless important that local authorities be given early notice of the terms of your announcement, which should, of course, accord exactly with the terms of the instructions to the draftsman of the proposed Bill.

I am sending a copy of this letter to the Prime Minister, and the other recipients of your minute.

Lawson

Pa 472

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LOCAL Gov. & Relations

Pg 35





B

2 MARSHAM STREET
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My ref:

Your ref:

Paul Gray Esq
Private Secretary to
The Prime Minister
10 Downing Street
LONDON
SW1A 2AA

6 July 1988

Dear Paul

RSG SETTLEMENT 1989/90 ETC

As you know, the plan is that my Secretary of State should make an oral statement in the House of Commons tomorrow afternoon on the RSG Settlement for 1989/90 and related matters.

The text of the statement cannot, of course, be finalised until after discussions at E(LA) this evening and Cabinet tomorrow. But I attach a draft statement on the assumption that colleagues reach agreement on the terms of tomorrow's announcement. Subject to that, I would be most grateful for any comments which you or copy addressees may have by 10.00am tomorrow, Thursday 7 July.

I am copying this to Alex Allan (Chancellor of the Exchequer's office), Jill Rutter (Chief Secretary's office), Jon Shortridge (Secretary of State for Wales' office), Alison Smith (Lord President's office) and to Richard Wilson in the Cabinet Office.

John Rutter
Roger

R BRIGHT
Private Secretary

LOCAL GOVERNMENT FINANCE

With permission I would like to make a statement, Mr Speaker, about a number of matters which will bring local authority finance up to date for the introduction of the new system in 1990.

First, my Rt Hon Friend, the Secretary of State for Wales, and I are issuing a consultation document today on local authority capital expenditure. The paper has been placed in the Library and is available in the Vote Office: it will be sent to local authorities and their associations today.

The new system will be a control on borrowing and the use of credit rather than on expenditure, which I believe authorities will welcome.

Local authorities will be free to spend their cash-backed receipts in whichever year they like once a proportion of them has been applied to debt redemption. Local authority debt now stands at about £45 billion. Local authorities will also be free to finance capital expenditure from revenue contribution, subject only to the discipline of the community charge.

Second, under the new system in the Local Government Finance Bill, revenue support grant is to be paid on a fixed basis, the discipline coming from the community charge. There will be no hold-back or grant forfeit for overspending and authorities will have certainty about their grant entitlements. My Rt Hon Friend and I have decided to pave the way towards this new system by introducing greater certainty for 1989/90.

In doing so, we will also remove any temptation for authorities to indulge in creative accounting by reducing reported "total expenditure" without changing their real spending. There are a number of ways in which authorities could do this for next year, this year and, indeed, earlier years, which we think should be forestalled.

ie not in the spill-over - I gather the Lord President sees strong objections to that.

We therefore propose to bring forward legislation during the next session to alter the basis on which grant will be paid. It will propose that grant payments for 1989/90 should be calculated not on authorities' reported total expenditure, but on a figure derived for each authority from total expenditure information already available. We envisage, at present, that the assumed level will be derived from their likely total expenditure during the current year, projected forward and allowing for changes in functions where appropriate. In making the assumptions, we shall use only that information about total expenditure which was with our Departments by midnight last night.

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The RSG Settlement for 1989/90 will be made in the Autumn. I should explain that the Report will be made before the Bill has been enacted and must therefore be made in accordance with the existing legislation. Once that Report has been approved and subject to Parliament approving the new legislation, grant will be paid on the new basis. Authorities will then know their grant entitlements, which will not depend on their spending decisions.

For the current year, and for the previous three years, final Supplementary Reports have not yet been made. For some of these years it would still be open to local authorities to undertake bookkeeping transactions or financial deals unrelated to real spending but which alter the level of reported total expenditure and therefore gain extra grant. We envisage that the Bill will provide that for all years up to 1988/89 grant entitlements should be calculated in general using total expenditure information which was with our Departments by midnight last night. The Supplementary Reports which are to be made this Autumn will, of course, be made in accordance the existing legislation.

This will provide local authorities with greater certainty about their RSG entitlements for 1989/90 and previous years. It provides a basis for an orderly transition to the new system and for bringing the existing system to a close. Without the new legislation, it would have been necessary to recalculate grant under the present system well into the 1990s. I hope it will now

be possible to make the last Supplementary Reports under the present system during 1989/90 - otherwise I would have been asking the House to approve them probably up to 1992 or 1993.

Third, my proposals for next year's RSG Settlement for England. I propose to set the level of provision for current expenditure at £29,000 million. This is [4.%] or [£1.2] billion more than authorities' budgets for this year, after deducting the cost of polytechnics which from next April will be the responsibility of central Government.

This sum includes £110 million in respect of the current costs next year for preparing for the introduction of the community charge. This is in line with the estimate of these costs made by Price Waterhouse, and is consistent with the figures put forward by the local authority associations.

This provision should allow non-ratecapped authorities to keep their spending broadly level in real terms.

Since authorities continue to spend more than they need, I again intend that there should be a margin between the total of grant related expenditure assessments and provision.

I propose that aggregate Exchequer grant should be set at £13,575 million. This is £600 more than the Settlement allowed for this year, and is about £1.1 billion more than the probable outturn for 1988/89 after allowing for polytechnics. It represents an

increase of about 9% on the amount of grant that will be paid out. Under my proposals for closing down the system authorities will not lose grant next year if they spend more in 1989/90 than the provision I have announced.

A settlement on this basis and with spending held steady in real terms would enable most authorities to hold the increase in rates to less than the rate of inflation.

I shall be discussing all these proposals with the Consultative Council on Local Government Finance on Monday.

Fourth, rate limitation. I am today laying before the House a report setting out how general purpose authorities will be selected next year. The selection criteria I am adopting are the same as I adopted last year:

first, for authorities not selected in 1988/89, budgets of at least 12½% above GRE and showing growth of at least 6% since 1987/88;

second, for authorities that were selected in the current year, budgets of at least 12½% above GRE.

On these criteria no new authorities will be selected for 1989/90
Seven authorities are re-selected - Camden, Greenwich, Hackney, Lewisham, Southwark, Thamesdown and Tower Hamlets.

I am today also setting the expenditure levels for the seven rate-capped authorities at the same level as in 1988/89.

My Rt Hon Friend, The Secretary of State for Education and Science, will be laying a separate report designating the Inner London Education Authority and he will be setting an expenditure level. This completes the Government's proposals for designating authorities in England.

Agreed ms

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SECRETARY OF STATE FOR ENERGY

CABINET ON 7 JULY 1988

I attach a possible speaking note for your use in Cabinet tomorrow, prepared on the assumption that E(LA) accepts Mr Ridley's proposals.

R.T.J.

R T J Wilson
Cabinet Office
6 July 1988

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CABINET: THURSDAY 7 JULY

RATE SUPPORT GRANT 1989/90: SPEAKING NOTE

1. It is customary for E(LA) to meet at this time of year to agree on those elements of the Rate Support Grant settlement which are announced before the Summer Recess. E(LA) last night reached agreement on a package of proposals, to which I now seek the Cabinet's approval.
2. The 1989/90 settlement raises special difficulties because it will be the last in England and Wales before the introduction of the community charge. There is a very real risk that authorities may be able to exploit the Exchequer through creative accounting. They will have every incentive to do that, because the scope for creative accounting will expire at the end of 1989/90. At the worst, hundreds of millions of pounds could be at risk.
3. To counter these risks, the Secretary of State for the Environment has proposed that the existing grant system should be closed down early. Grant for 1989/90 would be fixed on the basis of the settlement assumptions, and would not vary with actual expenditure. Grant for all previous years would also be fixed on the basis of expenditure returns which authorities have already made. The scope for any further creative accounting would therefore be removed. E(LA) have agreed to this proposal.
4. Closedown would mean that the full amount of grant provided in the settlement would be paid out. No grant would be forfeited to the Treasury as in previous years. This needs to be taken into account in setting the grant total. E(LA) have therefore agreed to Aggregate Exchequer Grant of £13,575 million for England, an increase of £600m compared to 1988/89, just above expected inflation.

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a call of nearly
£1.4 billion on the
Reserve

5. E(LA) have also agreed that provision for local authority current expenditure in England should be £29,040 million. This will allow non-rate capped authorities to increase spending roughly in line with inflation. Seven general purpose authorities and the Inner London Education Authority will be selected for rate capping in 1989/90.

6. A Bill will be needed to close down the grant system in the way proposed. But it will be short and it will be a Money Bill. On this basis the Business Managers have reluctantly agreed that time can be found, despite the great pressures on ~~next Session's~~ Parliamentary timetable.

7. If authorities were to get wind of the closedown proposals, they would have every incentive to act quickly to undermine them. It is therefore important that they should be announced as soon as possible. I seek Cabinet's agreement that the Secretary of State for the Environment should announce the package this afternoon.

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