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cc:  
 PS/Chancellor  
 Sir Peter Middleton  
 Mr Anson  
 Mr H Phillips  
 Mrs Case  
 Mr Edwards  
 Miss Peirson  
 Mr Turnbull  
 Mr Potter  
 Mr Fellgett  
 Mr Call

Treasury Chambers, Parliament Street, SW.

Roger Bright Esq  
 Private Secretary to the  
 Secretary of State for the Environment  
 Department of the Environment  
 2 Marsham Street  
 London  
 SW1

15 June 1988

Dear Roger,

#### 1989-90 RATE SUPPORT GRANT SETTLEMENT

Your Secretary of State accompanied by Mr Osborn and Mr Roberts came to discuss the 1989-90 Rate Support Grant Settlement with the Chief Secretary. Also present were Mr Potter and Mr Fellgett from the Treasury.

Your Secretary of State said that the first issue to decide was when to close down the existing RSG system. That would have an impact on the appropriate settlement for 1989-90. An early closedown had been discussed in DOE and he noted that there were some worries on propriety.

The Chief Secretary said that he had two reservations about the proposal in the DOE paper. The first was political. He saw considerable difficulty in going through a normal RSG settlement and then switching to an entirely different basis mid-stream. This could anger colleagues and lead to accusation from local authorities that consultation had been undertaken on a false prospectus. Your Secretary of State agreed that these did present difficulties but noted that the action the Government was taking would simply stop local authorities manipulating the system to their benefit and to the Exchequer's cost. Continuing, the Chief Secretary said his second concern was on the financial impact of a fixed grant settlement next year. The Government would lose the grant underclaim in 1989-90. Moreover, there would have been no grant incentive in the new system for local authorities to reduce their spending - the control over the non-domestic rate that would exist in the new

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system would not be in place. He also saw presentational difficulties in appearing so obviously to reward vice and penalise virtue. Procedurally he saw difficulties in trying to keep the proposal under wraps until the announcement.

Your Secretary of State said that he did not dissent from the Chief Secretary's conclusions. But he pointed out that there was a potential reclaim of grant of up to £350 million worth of grant for 1987-88 and 1988-89 and that next year there was a possible grant overclaim of £450 million. Mr Roberts explained that the £350 million was identifiable from the DOE's knowledge of local authorities' potential genuine underspending and from use of special funds in those years. The future number was inevitably more speculative. Your Secretary of State added that the objections the Chief Secretary had outlined to closing down the RSG system would apply whenever it took place. But without action to close down the system the Exchequer was at permanent risk that the local authorities would use the £1½ billion funds available to them to reduce expenditure and reclaim grant. He accepted that this was an argument for a tighter RSG settlement in 1989-90. Mr Fellgett said that grant effects could be forestalled by assuming that the funds would be drawn down. Your Secretary of State said that he was concerned that authorities would draw down the funds next year and then restore them in the first year of the community charge, blaming the Government for high community charges in the initial year while picking up the additional grant available in 1989-90. He pointed out however that the incidence of funds was patchy.

The Chief Secretary said that the figure of £450 million was new to him and had not been put previously to Treasury officials. He would wish to look at this point further. His reaction going into the meeting was that the balance of advantage was against an early closedown of the RSG system. Your Secretary of State said that the issue would need to be looked at carefully to see how to limit Exchequer liability. Mr Osborn said one option would be to re-introduce the block grant cash limit which had been abolished in 1987-88. The Chief Secretary suggested that officials should look at the estimate of the 1989-90 overclaim and to look at ways of achieving a cost effective closedown.

Your Secretary of State said that taking the final three years of the RSG system together some £800 million was at risk. If reclaim of that money could not be stopped it would have to be considered to what extent the Rate Support Grant could be reduced to offset that effect. That had the presentational difficulty of reducing grant to well below the levels mentioned in the context of the first year of the Community Charge. That was an argument for choosing the closedown route instead. However, his preference was to avoid further legislation if it was possible. There were presentational difficulties in simply cutting RSG to compensate while allowing those with

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balances to exploit the system. The Chief Secretary thought that officials should see if there was a way of producing a system which would be defensible. Your Secretary of State agreed that there was a considerable dilemma here. The Chief Secretary said that once he and Mr Ridley had seen the arguments set out it might be sensible to put a paper to the Prime Minister, the Chief Whip and the Chancellor. It would not be appropriate to go wider than such a restricted group in view of the sensitivity of the proposals.

The Chief Secretary noted that discussions should proceed in E(LA) in the normal way meanwhile. Your Secretary of State said that colleagues' attention would have to be drawn to the fact that there was a risk of a massive drawdown of balances in the last year of the system. That would point toward a much more restrictive settlement than he had envisaged before he had become fully aware of this problem and, if the system was not closed down, pointed to his moving below option (ii) on provision and grant that he had preferred.

Yours,

Jill

JILL RUTTER  
Private Secretary

Mr  
Parsons  
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This does all put  
a rather different  
complexion on things.  
Difficult to know which  
way to go ~~until~~ until  
further advice from  
officers received

AA