

passed on  
to PSI/CST

[CST was happy  
but she will  
take forward  
with Benny P]  
You said you  
would minute

m.

*passed  
B/S/K/S*

*This (2 submissions) is all under Baker's genl, sub top  
No Potts) is all under Baker's genl, sub top  
I will advise (S) to give  
clearance for  
No down BOP  
that we must also take  
No down BOP  
that we must also take  
No down BOP  
that we must also take*

FROM: S KELLY  
DATE: 4 JULY 1988

- 1. MR FARTHING
- 2. CHIEF SECRETARY

- PS/Chancellor
- Sir Peter Middleton
- Mr Anson
- Mr Phillips
- Mrs Case
- Mr Edwards
- Mr Turnbull
- Mr Potter
- Mr Fellgett
- Mr Call

*Ch  
This all seems v wet: grand  
total of 7 ordinary authorities + ILEA  
intercepted, compared to 17 ordinary authorities  
+ ILEA + all PTAs, Fire & Police authorities  
(automatically) last year. But probably not  
worth fighting legal advice,  
especially since the need to  
be announced at the same  
time as RSE down  
etc. AA*

PRECEPT LIMITATION OF ILEA IN 1989-90

Mr Potter's submission of 1 July offered advice on the various other proposals for rate capping in 1989-90, but said that we would submit advice separately on ILEA. I recommend you to accept the proposal in Mr Baker's letter of 16 June for an EL for ILEA in 1989-90 of £940 million. If you are content, it is probably sensible to amend the draft letter to Mr Parkinson, attached to that earlier submission, to include agreement on ILEA. A revised draft letter, agreed with LG, is attached.

2. The proposed EL for ILEA of £940 million is less stringent than ideally we should have liked. Mr Baker's estimate of required savings of £70 million is nearer to the £65 million which he now estimates ILEA will achieve this year than the £90 million that the 1988-89 EL was intended to secure. Moreover, although Mr Baker presents his proposal as a cash freeze on the 1988-89 EL - and therefore consistent with Mr Ridley's proposals for general purpose authorities - and whilst it takes account of the £45 million reduction in ILEA's need to spend as a result of transfer of polytechnics and other higher education colleges to the new PCFC sector, that comparison takes no account of either the £15 million by which ILEA's initial 1988-89 EL was redetermined last December or the increase in its precept maximum in January in order to allow it to raise a further £15 million. Both you and Mr Ridley made it an express condition of agreement to

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redetermination that the additional £15 million should form no part of the base for the 1989-90 EL. The increase in the precept maximum had no effect on the EL, albeit on a technicality. A genuine cash freeze on 1988-89, therefore, would imply a 1989-90 EL of £910 million.

3. An EL next year as low as £190 million is impracticable. It would require savings compared to ILEA's 1988-89 budget of some £100 million, or almost 10 per cent - a larger year-on-year increase than has ever been achieved by any authority. The limit of practicable savings is probably nearer to the £85 million implicit in allowing one, but not both, of the additions to the 1988-89 EL to feed through into 1989-90 (ie an EL of £925 million). Savings of £85 million next year would be slightly less in absolute terms, although greater as a proportion of total spending, than the £90 million which Mr Baker believed would have been achievable this year.

4. We have considered carefully whether to recommend you to press for an EL of £925 million. We have reluctantly decided against it. Mr Potter's submission set out the unsatisfactory position on rate capping generally next year and the particular difficulties in relation to those single purpose authorities, including ILEA, previously subject to automatic limitation. To the extent that you were to press for a more stringent EL for ILEA, that would increase the chance of a legal challenge by ILEA, and of that challenge being successful, which might affect not just ILEA but the whole rate capping package. The additional saving in ILEA's spending next year which you might achieve is simply not worth the risk. This is especially so against the background of reduced concern about the level of inner London community charges in 1990-91. I understand that, for the same reasons, DOE officials are advising Mr Ridley also to accept Mr Baker's proposals.

*Stephen Kelly*

S KELLY

REVISED DRAFT LETTER FOR SECRETARY OF STATE FOR ENERGY

RATE LIMITATION: 1989-90

Nicholas Ridley has circulated proposals for rate capping certain general purposes local authorities in 1989-90. I have also seen the letters from Douglas Hurd, Kenneth Baker and Paul Channon setting out proposals for those single and joint purpose authorities for which they have responsibility. Given that both Douglas Hurd and Paul Channon do not believe it would be practical to limit any of their authorities, we face the prospect of applying rate limits only on seven general purpose authorities and ILEA in 1989-90.

It may be helpful if I set out my views at this stage. I do not wholly share Nicholas' view that his proposal to select only seven general purpose authorities for rate capping this year is a vindication of the rate capping system. I accept that there has been some progress in reducing underlying current expenditure in one or two authorities. Indeed nine of the ten authorities which were rate capped this year cannot be rate capped next year because they have reduced their reported total expenditure below the GRE + 12½% threshold. But that owes just as much to creative accounting used to drive a wedge between their reported

total expenditure and actual underlying current spending as to any genuine reduction in spending. In many of these authorities underlying expenditure remains unacceptably high.

Nonetheless I appreciate that the selection criterion to be applied to authorities previously rate limited in this year cannot safely be tightened further in the view of the legal advice given earlier. Nor can there can be any question of taking more vigorous action in the last year of the present scheme to change the basis of selection from the unsatisfactory concept of total expenditure in order to bring more authorities within the net. I am therefore reluctantly prepared to agree that only the seven general purpose authorities identified by Nicholas should be rate capped in 1989-90.

Our scope for selecting both passenger transport authorities (PTAs) and joint fire and civil defence authorities (FCDA's) also seems to be fettered by legal advice that we have been given. Because we have indicated that Expenditure Levels (ELs) for the present year for the PTAs represent a reasonable balance between the interests of the ratepayer and the transport user, I can well understand why lawyers advise that those same ELs cannot now be deemed excessive in the terms required under the 1984 Rates Act in order to justify

selection for rate-capping next year. This is to say the least unfortunate and I fear that one or two of these authorities may take the opportunity, while they have escaped from the net, to increase their spending and the precepts they make upon local ratepayers. But again I am reluctantly forced to accept that there is little we can do but accept that no joint police, FCDAs and PTAs can be rate capped next year.

I agree with Kenneth Baker that ILEA can and must be rate capped next year.

I am concerned, however, at how we present the overall picture which emerges of only seven general purpose authorities and only one other authority - ILEA - being subject to rate limitation next year. I accept that the Environment Secretary is not required under the terms of the Act to explain why an authority has not been selected. Yet I do not suppose it will take long for ILEA and perhaps one or two other authorities to question why PTAs and FDCAs whose expenditure exceeds the GRE + 12½% criterion proposed for selection this year have not in fact been selected. I think it is crucial that we present our defence in terms of the ELs for both the FDCAs and PTAs for this year as having been reasonable rather than excessive. What must not be done is to imply in any way that the failure

to select these authorities is some kind of reflection upon the accuracy of their GREs. That would be a particularly dangerous line to follow: it could prejudice our ability not only to rate cap ILEA but also some of the general purpose authorities. I suggest that DOE, DTp, Home Office, DES and Treasury officials should agree on how the rate limitation proposals should be presented.

As regards the level of ELs, I am content with Nicholas' proposal to set ELs for 1989-90 for the general purpose authorities as a cash freeze on their 1988-89 ELs; I believe that represents an acceptable balance between maintaining the downward pressure on these authorities' expenditure, while avoiding requiring excessive cuts in the level of services.

I am also prepared, albeit very reluctantly, to accept Kenneth's proposal for an EL for ILEA next year of £940 million. I should have preferred an EL at least £15 and ideally £30 million lower in order to reflect a genuine cash freeze on ILEA's 1989-90 EL. I can only agree to a figure as high as £940 million in the light of the wider considerations to which I have already referred. My agreement to such a high initial EL means that ILEA would need to present an overwhelming case before I could agree to redetermination at a still higher level. As Kenneth envisaged in his letter, we shall also need to look very carefully at the precept

maximum in order to ensure that there is no scope for ILEA to boost its spending from other sources.

Finally I think there is an important wider lesson to be drawn from this year's experience. In 1989-90 we now face the prospect of capping only a very small number of authorities. Moreover all authorities will know that, because of the change in the capping arrangements from the present year arrangement which operates on the preceding year's budget to the new in-year control system, authorities can spend up in 1989-90 with no danger of being capped as a result. In the circumstances there is a danger of a surge in expenditure and we will therefore need to give careful consideration to our precise proposals for Community Charge capping. It will be important to retain the maximum flexibility to apply Community Charge capping on as wide a basis as seems desirable in the light of the budgets and Community Charge proposals produced by authorities in 1990.

I am copying this letter to the other members of E(LA) and Sir Robin Butler.



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*pmf*



2 MARSHAM STREET  
LONDON SW1P 3EB  
01-212 3434

My ref:

Your ref:

The Rt Hon Cecil Parkinson MP  
Secretary of State  
Department of Energy  
Thames House South  
Millbank  
LONDON  
SW1P 4QJ

CHIEF SECRETARY	
REC	5 JUL 1988
Mr Potter,	
Cx Sir Middleton	
Mr Dawson, Mr Phillips, Mr Edwards	
Mr Tombull, Mr Jellgelt, Miss Noble,	
Mr Wood, Mrs Case, Mr Call.	

July 1988

*Dear Cecil*

RATE AND PRECEPT LIMITATION 1989/90

Since colleagues and I last corresponded about next year's rate capping round, the meeting of E(LA), when we were planning to discuss our proposals for capping, has been cancelled. In these circumstances I suggest we might seek to agree our various proposals by correspondence, and hence I am now writing to seek your agreement to my proposals for general purpose authorities, and to let you know my views on colleagues' proposals for their joint authorities.

My own proposals were set out in my Memorandum (E(LA)(88)3) of 17 June. I believe the selection criteria I am proposing are the tightest we could adopt without an unacceptable risk of legal challenge, and my proposals for Expenditure Levels (ELs) will continue to maintain pressure on the overspenders. I recognise that some colleagues might be concerned about the effects of these ELs on some of the authorities I propose to cap, but I believe the proper time to have regard to these specific concerns is at the redetermination stage when we can take a hard look at any representations authorities may wish to make about their individual circumstances. I should therefore be grateful for your agreement to proceed on the basis of these proposals.

I have considered carefully colleagues' proposals for ILEA, the Passenger Transport Authorities, and the joint Police and joint Fire and Civil Defence Authorities. Given the legal advice they have received, I am content with Douglas Hurd's and Paul Channon's proposals not to select any of their joint authorities. As I said in my letter of 21 June to Kenneth Baker, it is important that ILEA is securely capped and that further significant reductions are achieved in their spending. On the other hand it is also important that we do not constrain ILEA so tightly that the smooth reorganisation of education in inner London is put in jeopardy. I am therefore content with Kenneth's proposal to select ILEA and to set an EL of £940m.



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In my earlier correspondence with colleagues, I also mentioned the importance of presenting our various decisions on capping in such a way as to avoid any inconsistencies which could be exploited in a legal challenge. I should be grateful if our officials could keep in touch about how we present our various decisions both at the time when we announce them and subsequently through the capping round.

I am copying this letter to the other members of E(LA), to the Attorney-General, and to Sir Robin Butler.

*Yours truly*  
*Nicholas*

NICHOLAS RIDLEY

CONFIDENTIAL

CHIEF SECRETARY

FROM: B H POTTER

Date: 1 July 1988

cc: PS/Chancellor  
Sir Peter Middleton  
Mr Anson  
Mr Phillips  
Mrs Case  
Mr Edwards  
Mr Turnbull  
Mr Revolta  
Mr Farthing  
Mr Williams  
Mr Kelly  
Mr Fellgett  
Mr Call

## RATE CAPPING 1989-90

We have agreed with Cabinet Office that it would now be best to handle rate capping in correspondence. Accordingly this submission covers the following proposals on rate limitation in 1989-90:

- that seven general purpose authorities should be capped (the Environment Secretary's paper E(LA)(88)3 refers)
- that no passenger transport authorities (PTA) should be selected (Transport Secretary's letter of 16 June);
- that no joint police or fire and civil defence authorities (FCDAs) should be rate capped: (Home Secretary's letter of 21 June); and
- that ILEA should be rate capped (Education Secretary's letter of 16 June).

2. I recommend that you agree to all the above proposals. I also suggest that you agree to the Expenditure Levels (ELs) proposed for the seven general purpose authorities but reply separately on the question of the EL for ILEA.

### The General Purpose Authorities

3. Under the Rates Act 1984 the Environment Secretary can select for rate limitation any local authority whose expenditure is deemed excessive. Section 2 of the Act requires that excessive must be measured in terms of total expenditure as defined in Part 6 of the 1980 Act. In practice the criteria for selection refers to threshold set on absolute levels of total expenditure and year on year growth. Each authority selected is given a maximum expenditure level (EL) again defined in terms of total expenditure, to which the rate cap is linked.

4. But creative accounting gives scope both for avoiding selection - by manipulating reported total expenditure so that it is below the thresholds - and exceeding the EL.

5. For 1989-90, Mr Ridley proposes that a single selection threshold on total expenditure - GRE + 12½% as this year - should be set. On this basis seven authorities would be selected. We agree with DOE officials assessment that this year the reduction in the number of authorities selected from 17 to the proposed 7 reflects some progress this year in underlying current expenditure. But it is due in greater part to their skill at creative accounting games. Nine of the ten which have escaped the threat of rate capping next year by getting their expenditure under the critical GRE + 12½% threshold, are still spending in underlying expenditure terms well over the GRE + 12½%. And ideally we would have wished to rate cap these. But DOE have taken legal advice that any attempt to tighten the criteria could well be the subject of legal challenge. And, as it happens, even if the legal advice had allowed us to go for a tigher limit at the theoretical maximum of GRE + 10% (that is the point at which the slope of the grant schedule becomes steeper), we would only have captured one further authority and even then only just.

6. We conclude there is no scope to reselect any more than seven of the seventeen authorities selected last year. In principle we could seek to cap other authorities next year not selected in 1988-89. In the past, two criteria have been applied for selecting new authorities in any year ie those not selected in the previous year. If we applied only one for 1989-90 - the same as for those previous selected - a further four authorities - the City of London, Blackburn, Bristol and Leicester - have set budgets for 1988-89 above the selection threshold. But we cannot select the other three without including the City.

7. Given the legal advice the choice lies between the seven authorities proposed by Mr Ridley or taking in the extra four identified in the preceding paragraph. The position is unsatisfactory: but it would be quite impossible to persuade Mr Ridley to take the legislative action necessary to change the basis of the selection criteria ie total expenditure in order to capture any further authorities this year. Nor will he wish to rate cap the City. I recommend that you accept Mr Ridley's proposals.

#### Other authorities

8. Following abolition of the metropolitan counties and the GLC, certain joint boards and single purpose authorities then formed were automatically subject to precept limitation for the years 1986-87, 1987-88 and 1988-89. Now, like the general purpose authorities can only be rate capped if they meet the general criterion for rate limitation.

#### (a) Passenger Transport Authorities.

9. It had been expected that selection would be possible in 1989-90 for some PTAs. Three of them had budgets above GRE + 12½% threshold this year. But these expectations have been upset by recent legal advice to the effect that the Secretary of State can only limit PTAs precepts in 1989-90, if he had made it clear

*Ridley*

- when setting their expenditure levels for this year - that such expenditure was still excessive, or if there had been a substantial change of circumstances since then. Neither of these conditions hold and Mr Channon is not willing to take the risk of legal challenge.

10. The loss of precept limitation powers over PTAs is not in itself a major setback. DTp would have been prepared to permit expenditure increases in line with inflation. In the absence of controls expenditure will go up by more than that but probably not dramatically so. PTAs are not geared up to make large increases. Under the deregulated bus regime increasing subsidies is not a simple procedure and it requires a tendering exercise for each subsidised route. PTAs do expect to be precept limited if they generally increase their expenditure. HE's advice is that we should not oppose Mr Channon's proposals.

(b) Joint police and FCDAs.

11. Because of the legal advice given, it seems that none of the joint police authorities or FCDAs could be regarded as having spent excessively in terms of the 1984 Act either. Home Office have never argued that the spending of their joint bodies was excessive. Indeed in introducing precept limitation in 1986, the Home Secretary said that this was taking place not because he thought there was serious overspending by the authorities but to prevent the creation of extravagant and expensive bureaucracies. The Home Office have maintained the line every since.

12. None of the joint police authorities is spending more than 12½% above GREs and could not be selected in any case. But spending by some FDCAs is well above their GREs and applying the common threshold would mean they ought to have been selected. Nonetheless, subject to the comments made about the presentation below, in view of the Home Secretary's failure to describe their ELs as excessive in the past and given the legal advice, again we have to accept that no FDCAs can be capped.

(c) ILEA

13. Mr Baker is content that ILEA should be rate capped. Fortunately he has made it quite clear in the past that he regards their existing ELs as excessive; each year's EL has been presented as steps downwards towards to an acceptable level of spending.

#### Presentation

*True*  
14. To sum up therefore it is proposed that the seven general purpose authorities and ILEA should be rate capped in 1989-90. But there is a potential problem of presentation. Under the provisions of the Rates Act 1984, the Environment Secretary is not required to explain why an authority has not been selected. But the fact that a number of PTAs and FCDAs with spending above the GRE + 12½% threshold applied to other authorities have escaped from precept limitation, might be used by ILEA to challenge its own selection. In ILEA's case as already noted Mr Baker did say that expenditure was still excessive when he set the 1988-89 EL so the legal grounds for limiting the precept in 1989-90 are present. But the danger comes from what might be said by DTP or Home Office Ministers or officials in justifying the absence of precept limits. If critics point to the fact that for example some PTAs have expenditure more than 12½% above GRE, it is essential that DTP should not say that public transport GREs are unreliable (which they are): exactly the same argument could be applied to ILEA and indeed to the general purpose authorities.

15. DTP officials have assured us that they do not intend to deprecate public transport GREs publicly and that they are prepared to justify the absence of precept limitation for PTAs in whatever way will limit the repercussions most effectively. This means relating the decision to the specific circumstances of the PTAs. The formula used by Mr Channon when he announced the 1988-89 ELs - that they ensured a reasonable balance between the needs both of ratepayers and the public transport users would be acceptable. But some similar form of words will need to apply to Home Office and the decision not to select the FCDAs. This is an important point and will have to be pursued by officials.

Longer term considerations

16. As you are aware we are taking steps to tighten the capping regime under the Community Charge which takes over in the year after next:

(i) the system will operate in-year so the criteria can be set after we have local authorities budgets;

(ii) the system will allow DOE to take into account all sources of local authority finance ie including the likely use of creative accounting.

17. So we ought to be able to avoid the kind of creative accounting that has so limited the freedom of action this year. It is worthwhile drawing attention to the improved arrangements for next year and to warn colleagues now that we may have to look for wide application of Community Charge capping to keep charges down to an acceptable level.

Expenditure Levels (ELs)

18. Finally, for the seven general purpose authorities Mr Ridley proposes that there should be a cash freeze on their expenditure levels. I recommend that you agree to this: it is in line with the practice for the previous two years. It is conceivable that Mr Moore may object that this will impose unacceptably low standards for personal social services provision. But following discussion at official level, I do not think he will be able to mount a serious challenge. I have agreed with HE2 Division that they will brief separately on the EL for ILEA.

19. I attach a draft letter for you to send to the Energy Secretary, as Chairman of the E(LA).

*Robi Fellgett*

pp BARRY H POTTER



DRAFT LETTER FOR SECRETARY OF STATE FOR ENERGY

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Nicholas Ridley has circulated proposals for rate capping certain general purposes local authorities in 1989-90. I have also seen the letters from Douglas Hurd, Kenneth Baker and Paul Channon setting out proposals for those single and joint purpose authorities for which they have responsibility. Given that both Douglas Hurd and Paul Channon do not believe it would be practical to limit any of their authorities, we face the prospect of applying rate limits only on seven general purpose authorities and ILEA in 1989-90.

It may be helpful if I set out my views at this stage. I do not wholly share Nicholas' view that his proposal to select only seven general purpose authorities for rate capping this year is a vindication of the rate capping system. I accept that there has been some progress in reducing underlying current expenditure in one or two authorities. Indeed nine of the ten authorities which were rate capped this year cannot be rate capped next year because they have reduced their reported total expenditure below the GRE + 12½% threshold. That owes just as much to creative accounting used to drive a wedge between their reported

total expenditure and actual underlying current spending than to any genuine reduction in spending. In many of these authorities underlying expenditure remains unacceptably high.

Nonetheless I appreciate that the selection criterion to be applied to authorities previously rate limited in this year cannot safely be tightened further in the view of the legal advice given earlier; and there can be no question of taking more vigorous action in the last year of the present scheme to change the basis of selection from the unsatisfactory concept of total expenditure in order to bring more authorities within the net. I am therefore reluctantly prepared to agree that only the seven general purpose authorities identified by Nicholas should be rate capped in 1989-90.

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selection for rate-capping next year. This is to say the least unfortunate and I fear that one or two of these authorities may take the opportunity, while they have escaped from the net, to increase their spending and the precepts they make upon local ratepayers. But again I am reluctantly forced to accept that there is little we can do but accept that no joint police, FCDS and PTAs can be rate capped next year.

I agree with Kenneth Baker that ILEA must be rate capped next year.

I will write separately shortly on what the EL for ILEA might be. I am content with Nicholas' proposal to set ELs for 1989-90 for the general purpose authorities as a cash freeze on their 1988-89 ELs; I believe that represents an acceptable balance between maintaining the downward pressure on these authorities' expenditure, while avoiding requiring excessive cuts in the level of services.

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*pmf*



2 MARSHAM STREET  
LONDON SW1P 3EB  
01-212 3434

My ref:

Your ref:

The Rt Hon Cecil Parkinson MP  
Secretary of State  
Department of Energy  
Thames House South  
Millbank  
LONDON  
SW1P 4QJ

CHIEF SECRETARY	
REC	5 JUL 1988
<i>Mr Potter,</i>	
<i>Cx Sir Middleton</i>	
<i>Mr Dawson, Mr Phillips, Mr Edwards</i>	
<i>Mr Tombull, Mr Jellgelt, Miss Noble,</i>	
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July 1988

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*Yours truly*  
*Nicholas*

NICHOLAS RIDLEY