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→ APS/Chancellor

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CHIEF SECRETARY TO THE TREASURY

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cc Mr Tyrie

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23 June 1988

RATE SUPPORT GRANT/CAPITAL CONTROLS

Your Secretary of State had a meeting yesterday evening with the Chief Secretary to discuss closing down the RSG system and the issues on local authority capital expenditure raised in the Chief Secretary's letter of 22 June. Also present were Messrs Osborn, Parker and Roberts from the Department of the Environment and Messrs Edwards, Potter and Fellgett from the Treasury.

Your Secretary of State said that he thought the issue was quite simple. Unless there were early closedown, local authorities could find two routes to maximise their grant entitlement - first by drawing down their balances in special funds and secondly by capitalising repairs and hence avoiding revenue expenditure. The way to stop that grant maximisation was to closedown the system quickly. Trying to act on spending rather than grant would require draconian measures. He drew a distinction between preventing local authorities from milking the Exchequer through over-claiming grant which he regarded as something that needed to tackled and stopping local authorities using what were after all their own resources to finance expenditure. Only the former put the Exchequer at risk and he concluded that the way to avoid that was to closedown the RSG system early.

The Chief Secretary noted that this would require legislative cover. Your Secretary of State said that applied whever the system was closed down. He believed that the risk of a spending spree in the last year could be avoided by giving less grant in the final RSG settlement than would otherwise be provided. The size of the rates hike necessary to finance additional spending would thus provide disincentive to high spending.

The advantages of early closedown as he saw it was that it prevented local authorities manipulating grant in the future and since the system would have to be closed down at some juncture it was better to act sooner rather than later. Mr Roberts pointed out that this was a rare window of opportunity because there were no court cases outstanding. It might not be possible to closedown the system in July next year but DOE could be certain they could do it this year. He added that DOE simply did not know the scope for exploiting sytem through creative accounting and the route of early closedown avoided the need for piecemeal measures to stop up the system.

The Chief Secretary said that he saw some some disadvantages in early closedown. It would remove the discipline on spending that the negative marginal rates of grant provided. He was also concerned about the likely developments on use of capital receipts once local authorities had seen that from April 1990 they would be expected to use 50 per cent of non-housing receipts and 75 per cent of their housing receipts to redeem debt. He believed that would give them a substantial incentive to accelerate spending. Mr Parker queried this. He noted the bulk of these receipts lay/with the Shire Districts and there was limited amount of extra expenditure on repairs that they could actually undertake. He pointed out the existing system already gave local authorities an incentive to capitalise revenue expenditure. He thought that additional spending could be of the order of £200 million. He cited the example of the change in 1986-87 when the Green Paper on local government finance had been publised foreshadowing a much more draconian control over receipts. There had not been a surge in capitalisation then. Mr Potter doubted whether this was a valid precedent. The consultation paper had been rapidly withdrawn and there had been no immediate intention to legislate. Moreover the size of the accumulated mountain of cash-backed receipts was now much larger.

Mr Potter thought that if action could be taken to limit the use of receipts that tilted the balance of preference strongly towards closedown in July next year. Your Secretary of State doubted both the practicality and political wisdom of taking action to limit local authorities use of receipts. He believed that it was essential to make first a decision on closedown and then see what consequent action was required. Mr Potter stressed that he was not suggesting a complete moratorium on the use of receipts for non-prescribed spending. Rather he was proposing preventing excessive use of receipts. Mr Parker said it was impossible to do this for part of a year. It would however be possible to replace the Secretary of State's general consent for the use of receipts for non-prescribed expenditure with specific consents for a whole year. But that would inevitably create a major row. Your Secretary of State said he did not believe it would justified. The money was only available for use on repairs. He thought that it would be better to take account of additional non-prescribed expenditure when setting the amount available for capital allocations with the Survey. The Chief Secretary pointed out that was not without problem itself. Mr Parker again reiterated the view that the likely use to boost repairs would be limited. Local authorities did not even use all the spending power arising from receipts now. Moreover, their auditors would have to accept that the use was legitimate. The Chief Secretary pointed out that the brick wall of April 1990 was likely to induce behavioural differences.

Your Secretary of State said he doubted that it would be possible to limit the use of receipts in the way the Treasury were suggesting. If the limitation were applied to restrain the use to the same level as in 1988-89 local authorities would suddenly discover a huge number of repairs in the pipeline. The DOE lacked the necessary information to implement the restraint proposed. It would cause similar problems to those caused by the 9 March announcement on barter. The Chief Secretary noted that this concern appeared inconsistent with the line the DOE were taking on the limited potential for use of receipts in 1989-90.

After further discussion, it was agreed that the capital consultation document should be held up until there were agreement on how to proceed on closedown and what further measures might be necessary in the light of those decisions. Your Secretary of State believed that if the late closedown option were chosen it might be necessary to take preventative measures on capital though with early close down he doubted that such measures were needed. It was agreed that officials should produce a paper assessing the advantages and disadvantages of options (i) and (iii) option (ii) could be excluded from present discussions though it could be retabled if necessary). The paper should also cover the issues on capital expenditure. The E(LA) discussion on Wednesday should not proceed. The aim would be to put the paper to the Prime Minister next week with a view to taking decisions.

JILL RUTTER