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My ref:

Your ref:

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Prime Minister

MUS 4/7

Dear Peter,

RATE LIMITATION LEGISLATION

Thank you for your letter of 12 July. I am glad to see that you agree generally with my proposals.

Choice of selective scheme

I agree that the selective scheme now put forward is a little different from that discussed in MISC 79 or E(LF). The main difference is that we should not on this approach require authorities to submit budgets, but set them maximum expenditure levels on a formula basis. We are agreed on the advantages of this approach.

You ask about the relationship between maximum expenditure levels and targets. This is of course an issue under either version of the selective scheme, since the targets - if we continue to have them - will need to be in an appropriate relationship either with the maximum expenditure levels (under my present version) or with the approved budget figures (under the previous version). Since the problem is essentially the same in both cases, it need not affect our choice between the two versions.

I agree with your analysis of the options for targets and maximum expenditure levels. As regards point a) in your letter, we have always recognized that because the maximum expenditure levels for rate control (unlike the targets for grant holdback), will in effect be binding figures, it will be necessary to ensure that they are achievable in a financial year. Otherwise we shall be obliged to grant substantial numbers of derogations if we are to avoid successful legal challenge. This implies some degree of headroom in the figures. On the other hand a small number of high spenders could be given tight maximum expenditure levels under the selective scheme in a way that would not be possible under the general scheme, since there will be far fewer applications for derogations for us to consider.

As regards point b), we shall need to bear in mind the political advantages of giving up targets once the legislation for control is in place. There would be some logic in saying at that stage that taken together the block grant system, with its built in disincentive to high spending for all, and the new rate limitation scheme, directed at the high spenders, made the target system superfluous. But we do not need to take a view on this for some time yet. I suggest that in the White Paper we leave it open.

As regards point c) there is a risk of anomalies if we have both grant holdback targets and maximum expenditure control levels and allow the figures to diverge ie the grant holdback targets would be tougher than the maximum expenditure levels. The problems were discussed in paragraphs 32 to 34 of the report annexed to my minute to the Prime Minister. The underlying reason for them is that holdback of grant leads to higher rates, unless authorities keep their expenditure down; it thus acts as an indirect incentive rather than a direct control. But once rates are controlled directly, grant holdback can have the effect of pushing rates up towards the limits that have been directly set if the local authority choose to ignore the grant holdback target whilst still remaining within the maximum expenditure for control purposes. I recognize the case for keeping targets and holdback under the selective scheme in order to preserve the disincentives to high spending for the authorities that are not selected. But we will have to consider very carefully whether it would be appropriate to keep them if we were to implement the general scheme. However I am content to leave that issue open in the White Paper.

Choice of general scheme

My reasons for preferring Model 2 to Model 1 were set out in my minute to the Prime Minister. In brief a) it would allow us to take account directly of authorities' circumstances and expenditure requirements; b) it would give rise to fewer applications for derogations; and c) it would follow on more naturally from the selective scheme since both would be based on explicit expenditure figures.

I recognize that it would produce a more irregular pattern of rate increases than Model 1, as I said in my minute, but for the reasons given I think that on balance it is preferable.

The imposition of targets and holdback on top of the general scheme of control would of course magnify the irregularity of the rate increase pattern, as you say. That is another reason why I am attracted to the option of abolishing targets and holdback if we ever have to introduce the general scheme. But I agree with you that we should not close that option at this stage. The White Paper should leave the issue open.

Borrowing and accounting conventions

I do not think we need any further statutory constraints on temporary borrowing, since authorities already need the Secretary of State's consent on this. As regards harmonising accounts, there is separate discussion going on between our officials about the possibility of new accounts regulations and a consultation document.

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I suggest we should let those discussions proceed rather than constraining them to the tight timetable of rate limitation. It is not easy to make rapid progress in this field given the number of interests involved and the differing views even within the accountancy profession.

I am copying this letter to the recipients of yours.

Your ever
Patrick

PATRICK JENKIN