

CONFIDENTIAL

CC NO



Prime Minute  
for a minute.

MEEN 13/9

PRIME MINISTER

LIVERPOOL

I have received a request from the City of Liverpool to allow them to borrow £25m to cover the shortfall between their planned revenue expenditure this year and the amount which they will raise from their illegal rate.

I do not intend to approve this for the following reasons:

i. Approval would be seen and certainly represented by Councillor Hatton as a major defeat for the Government and a triumph for their illegal action.

ii. Local authorities are rightly not allowed to borrow without consent against future years' income for revenue purposes.

iii. Liverpool would be making much worse the financial crisis which they face next year.

iv. It would set a most dangerous precedent for other local authorities who budget and rate irresponsibly.

This is a crucially important decision in the developing Liverpool saga and I think that you and our colleagues should be aware that it could lead to financial breakdown some time later this year. I attach a fuller report.

Mo -  
Liverpool's  
prosperity

I am copying this to other members of MISC 109, George Younger and to Sir Robert Armstrong.

K.B.

K B

13 September 1985

# CONFIDENTIAL

## MISC 109: LIVERPOOL SITUATION REPORT

### Background

1. On 14 June Liverpool Council increased its rate by 9%. That would raise only £229m against their budget of £265m. On 31 July they reduced their budget to £255m simply by reducing the contingency provision. On 25 July Liverpool were designated for rate-capping next year. Their expenditure level for 1986/7 was set at £245m (excluding expenditure to be inherited from Merseyside City Council).

2. On 5 September the Council announced, on the capital side a deferred payment deal which would provide £25m of capital funds this year and effectively safeguard the financing of the present programme of £112m. On the revenue side, there was no mention of quashing the rate. Instead they said that they would not be able to pay their way beyond 31 December unless they could borrow more money, and would shortly be sending out protective redundancy notices to their staff. This was subsequently altered after shop steward pressure to an announced intention to lay off staff, re-engage those needed to run emergency services and reinstate all staff by April 1986.

### Borrowing Consent Request

3. On 11 September Liverpool's Treasurer wrote a letter requesting my consent to borrowing, copy at Annex A. Our best interpretation of the letter is that consent is sought for revenue borrowing against revenues to be received in a future year. We must now decide quickly on our response to this very unusual request. I see this as a key decision in our handling of the Liverpool saga this year.

### Consideration of Request

4. I propose to reject the request for borrowing consent. Although I have the power to consent to borrowing for any purpose, it would be most unusual to permit borrowing for revenue purposes against the revenue expected in future years, and no authority could or should expect such permission. The proper approach is for an authority to balance its income and expenditure within the year. This is a cornerstone of the financial rectitude of local government, and plays a key role in maintaining the confidence of the financial markets. We can find no precedents for granting borrowing approval of this kind. Furthermore we would be setting a most dangerous contemporary precedent. We would have no control over the money we had enabled Liverpool to raise. We could be seen as underwriting their creditworthiness in the market, whilst at the same time generating concern in the market about a drift towards revenue borrowing. We could effectively increase Liverpool's spending power this year, if they have further accounting devices up their sleeve. Lastly and most importantly, a consent to borrow would certainly be seen as a humiliating climb-down by the Government, and as condoning Liverpool's illegal deficit budgeting.

# CONFIDENTIAL

5. We presently believe that there probably are financial devices still available to the Council, even without quashing and raising their rate, which could enable them to get through 1985-6, if they had the political will to do so. In particular, the Treasurer's latest report to the Council indicates the availability of some £27m of capital receipts at the end of 1985-6. If these receipts were used to capitalise maintenance and repairs spending this year, then it should be possible for Liverpool to get through the year. But the price of that would be to remove a substantial part of the financing of the 1986/7 capital programme, much of which is housing. A more detailed note of our understanding of the Council's financial position is at Annex B.

## Consequences of Rejection

6. I must, however, tell colleagues that the consequences of rejection could be very significant. There are two courses of action open to Liverpool, given a continuing unwillingness to quash their rate:-

i. They could adopt the capitalisation device described in the preceding paragraph, possibly with other adjustments and accounting devices, which would get them through 1985-6, but would bring their capital programme to a very early halt. They would seek to blame the Government for the abrupt halting of their housebuilding programme in the run-up to the elections next May. A note on Liverpool's housing programme is at Annex C.

ii. They could reject all such financial devices as being politically unacceptable, and thus make the City bankrupt. This would lead quickly to lay-offs, emergency cover only for service provision and eventually to the need to appoint Commissioners.

7. Under either course of action, the Council would be in trouble with their trade unions, particularly the manual unions who have hitherto been supporting them. The press cuttings at Annex D illustrate the tensions that exist between the Council and the trade unions.

8. All this is happening against the background of the quite separate proceedings under which the auditor has issued notices of surcharge and disqualification to councillors. On the likely assumption that the councillors appeal to the courts, the legal process could last well into 1986.

## Terms of rejection letter

9. If colleagues agree with my recommendation in favour of rejection, we must get the terms of the rejection letter right. The main ground for rejection must be the fundamental importance of the principle of an authority balancing its books within the year. I do not intend to make any reference to the various alternative options available to the Council, since that might be taken to open the door to negotiations to explore possibilities. I propose to refer only to the fact that the Treasurer indicated in a recent council paper that alternative options

# CONFIDENTIAL

are open to the Council, and that he stated his opinion that it "should take urgent action to reduce its net expenditure and to balance its budget."

10. A draft response on these lines is at Annex E. It will be important not to be drawn beyond the contents of such a letter.

## Other matters

11. Short notes on other issues are at Annex F. Colleagues will note that:

a. Surcharge and disqualification action is proceeding against Lambeth and Liverpool Councillors, who have said they will appeal against the auditor's decision.

b. I am presently advised that there is not yet firm evidence for stopping payments of Government grants to Liverpool, though we need continuously to review the propriety of such payments as the Council's financial position deteriorates.

c. Until a decision on the borrowing consent has been announced, we should not make the £5½m backdated payment to Liverpool in respect of the rate rebate element of Housing Benefit. The presentation of this payment will need very careful handling.

K B

13 September 1985