



PRIME MINISTER

OPTING OUT OF ILEA: FINANCIAL IMPLICATIONS

1 We are to discuss policy on opting out of ILEA in E(EP) on 30 July.

Timing

Wandsworth
2 On 2 July E(LF) agreed that 1 April 1990 was the earliest feasible date for the first transfers. Since then, the leaders of Kensington and Chelsea, Westminster and Wandsworth have told me of their strong preference for an earlier transfer. They suggest 1 September 1989, that is, at the beginning of the academic year. I have therefore reconsidered the position. But I believe that the boroughs' preferred timing takes insufficient account of the procedural uncertainties we face in the passage of the legislation and the making of subsequent Orders. It also underestimates the scale of the preparations which they will themselves have to make. In addition there is the financial complexity of a mid-year transfer, especially one which would fall at the very end of the present system of local government financing.

3 The establishment of London Regional Transport as a body separate from the GLC provides a precedent for a mid-year transfer of responsibilities. I attach an annex on the application of this precedent to the ILEA. The complex additions which would be needed to what is already a very large and complex piece of legislation, the risk of successful challenge in the courts and the likelihood that early transfer would not deliver the political advantages which the boroughs concerned seek from it lead me to the view that we should aim for first transfers in April 1990.

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Financial arrangements post-1990

4 On this basis, opting out boroughs would assume education functions at the same time as the reform of local government finance is introduced. A borough opting out would receive grant from the Exchequer for its new education function according to population and assessed need and the rump ILEA would lose accordingly. The new education authority would finance its service from its own resources and would not have to pay a precept to ILEA. It would finance its total spending after taking account of Exchequer grant from the community charge.

Limitation of precepts and charges

5 I will aim through precept limitation this year and next to reduce ILEA's expenditure by 15% in real terms. I am also looking at how to devise a workable manpower control. But in my judgement we cannot rely on ILEA's expenditure being less than 50% above GRE in April 1990. In his minute to you of 28 July Nick Ridley sets out proposals for the capping of community charges in the new system. We shall almost certainly need to limit the precept of the rump ILEA in 1990-91. If the opting-out boroughs inherit an education service spending at 50% above GRE, the criteria which Nick adopts to select local authorities for charge-capping are likely to catch at least one of the likely opters-out. There seem to me to be three options for dealing with that;

i to allow the selection criteria to operate but to show flexibility when an opting-out borough applies for a higher limit on the grounds that the overspend on education is no fault of their own, and on the understanding that they are taking steps to reduce it;

ii to designate the new education authorities automatically for charge-capping for, say, three years, like the joint boards created by the Local Government Act 1985. It might be easier than under option i to differentiate between authorities so designated and the wilful overspenders;

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iii to legislate for Inner London Boroughs who are successful in their applications to become education authorities to have a period of grace - say three years - before charge-capping is applied to them. We could stipulate that such a period was not available to an ILB with a record of over-spending on other services.

We shall need to decide soon which of these options we favour. My own preference is for option iii, if the group of ILBs who could benefit from the period of grace can be satisfactorily defined.

Equalisation of the business rate

6 The cost of the overspend on local services in Inner London is now shared between business and domestic rate payers in the ratio 3:1. With the unification of the business rate Inner London residents have in principle to pay for the whole of the overspend on local services through their community charge. This will affect boroughs which opt out and those which do not alike. We have agreed in E(LF) arrangements for phasing in the community charge gradually, and to consider whether an element of Inner London's non-domestic rate revenue might be retained within the capital for a transitional period. That would certainly ease the problems here described.

ILEA's overspend: the starting point for opting-out boroughs

7 I do not have the information to assess either what education GREs would be for individual Inner London boroughs, or how much ILEA spends in each of them. I shall need to take powers in my bill to gather this and other necessary information from ILEA; I do not think that ILEA will supply it voluntarily. In the meantime, my officials have carried out some rough calculations of GREs for the boroughs using the best data available. The results should be regarded with caution. But if we assume that ILEA's spending in 1989-90 is pegged back to 50% above GRE and that the pattern of spending across boroughs is in line with the GREs we have calculated, starting points would be broadly as follows:

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	education spending, £m	of which, overspend relative to GRE, £m
Kensington and Chelsea	45	15
Westminster	60	20
Wandsworth	105	35

8 The table assumes that boroughs inherit the ILEA average overspend. However, ILEA spreads its spending across the boroughs in relation to its own criteria. It may direct relatively more resources to areas with special social needs than does the GRE system. I hope to be in a position to explore this further in the autumn when LEAs will be required for the first time to publish information about the budgets of each of their schools. Opting-out boroughs will find that if ILEA's spending on them relative to their GREs is lower than the ILEA average overspend, they will need to raise a lower community charge than the rump ILEA. Westminster and Kensington and Chelsea have relatively low social needs; Wandsworth's needs are close to the ILEA average.

presumably
also the
higher
community
charges -
Camden,
Islington etc.

9 Secondly, although I am proposing block transfer of teaching and some other groups of staff, I intend that the opting-out boroughs should be free to set up their own administrative and support services. If, as I know they intend, they administer the service more cheaply than ILEA, their starting point will be lower than indicated above. That for the rump ILEA will be correspondingly higher: my staffing paper sets out proposals for a scheme to meet the costs of redundancies of resulting surplus staff, thereby preventing the costs from falling on community charge payers in Inner London.

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Impact of overspend on community charge

Again, higher charges in Camden etc.

10 The influence of overspend on the community charge will depend on the proportion of adults in the area. Kensington and Chelsea and Westminster have proportionately fewer under-18s than Inner London as a whole. If they opt out, overspending on education in their areas would be spread over a relatively large number of adults, resulting in a lower community charge: the "starting point" figures for the two boroughs are 25% lower per adult than the corresponding figure for ILEA as a whole. Wandsworth's child to adult ratio is close to the Inner London average.

Recoupment

11 Arrangements already exist under which an authority providing education for a pupil or student from another authority may recoup the cost. I have recently legislated to ensure that recoupment continues to be at standard rates, so that ILEA is not able to attract pupils and students from other areas into its schools and pass on in full its high spending to their home authorities. I intend that these arrangements should apply to the Inner London boroughs which opt out. Their financial effect depends on the net flows of pupils and students between boroughs; assuming that the opting-out boroughs inherit some at least of ILEA's high spending, a net importer of pupils stands to lose and a net exporter to gain. I shall need to ask ILEA for information about the movement of school pupils, but a preliminary estimate suggests that Westminster may be a small net importer and Kensington and Wandsworth net exporters. I do not expect any special measures to be necessary as regards schools recoupment. In further education, ILEA's high costs are due largely to its wide range of provision and low fee policies. It will be open to the Boroughs to increase adult education fees to help cover costs, but some transitional provision may be needed, for example to provide automatic recoupment for students who began courses before the transfer.

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Overall effect on community charge

12 On the basis of the information available to me I believe that at the outset, Kensington and Chelsea and Westminster may be able to charge their residents less for education than they would have to pay through the ILEA precept for the same level of service. The position for Wandsworth is likely to be neutral. All three boroughs will have the opportunity to reduce their initial overspend through a tighter central administration and, in the medium term, by other means. To the extent that the opting out boroughs are in a position initially to raise a lower community charge, the boroughs remaining in ILEA will need to raise a higher charge for the same level of service. The impact of that would be tempered by the redundancy scheme which I propose, and more generally, by the transitional arrangements now under consideration for Inner London.

13 If the opting-out boroughs as might be expected tackle the job of reducing excessive staffing and identifying savings in other areas more quickly and with greater vigour than the rump ILEA, those savings will feed through directly to a lower community charge.

CONCLUSION

14 I invite my colleagues;

- i to re-affirm our policy of making the first transfers of the education function to Inner London Boroughs who successfully apply for it in April 1990;
- ii to agree that boroughs whose application to become an education authority is successful and who are not over-spenders on other services, should have a period of grace before community charge-capping applies to them;

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iii to note that if the three boroughs which have so far declared a wish to become education authorities achieve their aim, they are likely to gain, or at least not to lose, from the decision and the rump ILEA is likely to lose. Since many of those London boroughs where the level of the community charge is likely to cause most concern are also likely to remain in ILEA, this emphasises the need to provide transitional protection against excessive levels of community charge in Inner London.

15 I am copying this minute to other members of E(EP) and E(LF), and to Sir Robert Armstrong.

K.S.

KB

Department of Education and Science

28 July 1987

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ANNEX

OPTING OUT OF ILEA: THE IMPLICATIONS OF FIRST TRANSFERS IN SEPTEMBER 1989

1. If all the relevant information were available by September 1988, it would be possible to allow for the financial consequences of boroughs opting out in September 1989 in the main RSG settlement for 1989-90. However, on the most optimistic assumptions about the legislative timetable, I would not know in September 1988 which boroughs were to opt out. Nor would I have the relevant financial and statistical data on which to carry out the block grant calculations on a borough basis: I will need to take the powers to require the ILEA to supply these in the bill itself. A block grant solution is therefore not feasible. I would need to make special arrangements.

2. The establishment of London Regional Transport as a body separate from the GLC provides a precedent for the mid-year transfer of responsibilities. In that case, the Transport Secretary took powers to require the GLC to pay the newly established body for the exercise of the transport function from the time of transfer to the end of the financial year. A similar mechanism could be adopted for ILEA, with the rump ILEA being required to transfer a specified sum to each of the opting out boroughs to enable them to provide education from September 1989 to March 1990. Powers would need to be taken in the Education Bill and exercised by Order; the financial Order would need to be separate from and subsequent to the Order for the transfer of functions because of the time needed to gather information and carry out consultations before it is laid.

3. The legal provisions would be more complex than in the LRT case. First, I would need to determine not only the sum which the ILEA should hand over but also how it should be divided among the recipients. Secondly, the recipients are part of the existing grant distribution system. Steps would need to be taken to ensure that if they spent more or less on education than the sum they received from ILEA, they would not gain or lose grant as a result. This would involve redefining total expenditure for these boroughs in 1989-90 to exclude their education expenditure and income from ILEA.

4. The calculation of the sum to be transferred from the ILEA to each of the opting out boroughs would need to be based on the expenditure level of the ILEA in 1989-90 and the notional education GRES for each of the inner London boroughs (these GRES would have also to be defined in the legislation). A difficulty would arise if ILEA's budget for the year, as it has in the past, exceeds its expenditure level. In this event the opting out boroughs would take over spending liabilities which they were unable to meet from their share of the ILEA expenditure level. The scope for savings particularly on staffing would be limited: decisions need to be taken before the start of the academic year. They would be unable to raise rate revenue in-year. Unless they had taken the undesirable step of raising a rate which would enable them to swell reserves, they would be potentially in

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serious difficulties. Under such circumstances, early transfer would not deliver the political advantages which the boroughs seek.

5. The ILEA would almost certainly challenge my decision on the sum to be transferred in the courts. The LRT experience suggests that the risk of successful judicial review is considerable.