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cc DS

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CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon George Younger MP
Secretary of State for Scotland
New St Andrews House
St James' Centre
EDINBURGH EH1 3SX

31 July 1984

Dear George

LOCAL AUTHORITY CAPITAL SPENDING IN SCOTLAND

with AT

Thank you for your letter of 5th July about the local authority capital cash limits in Scotland.

I am pleased that SO/LA1 was not overspent in 1983-84 and that you can take the usual penalty for the overspend on SO/LA2 in 1984-85 without needing any new measures to control spending. I am also pleased to hear that you do not expect there to be any overspend in 1984-85; this reflects the strength of the Scottish system which does not appear to permit overspending provided local authorities remain within the law. Nevertheless I should be grateful if our officials could keep closely in touch in order to ensure that things remain on course.

Finally, I can assure you that I fully appreciate the difficult decisions you have had to take in order to achieve this satisfactory position. It is heartening that they appear to be bearing fruit in avoiding the need for the measures we have had to take in England and Wales to control capital spending in the current year.

I am copying this letter to the Prime Minister, Willie Whitelaw, Leon Brittan, Keith Joseph, Nicholas Edwards, Patrick Jenkin, Norman Fowler, Norman Tebbit, Tom King, Nicholas Ridley and Grey Gowrie and to Sir Robert Armstrong.

Yours ever Peter

PETER REES

Local Govt: Rels.

- 2 AUG 1984

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NEW ST. ANDREWS HOUSE
ST. JAMES CENTRE
EDINBURGH EH1 3SX

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
HM Treasury
Parliament Street
LONDON SW1

5 July 1984

Dear Peter,

LOCAL AUTHORITY CAPITAL SPENDING IN SCOTLAND

I have now seen your reply of 29 June to Nicholas Edwards' and Patrick Jenkin's letters to you of 20 June and 22 June respectively.

The position in Scotland differs very substantially from that apparently existing in England and Wales. There are two cash blocks involved in Scotland. On the first (SO/LA1) we managed to contain expenditure in 1983-84 within the cash limit and see no problem for 1984-85. On the other cash limit (SO/LA2) you will recall that after protracted and difficult negotiations in the late autumn last year, we agreed arrangements for minising the damage done to our cash limit as a result of the open-ended commitment which we gave, at Treasury behest, in respect of house improvement and repair grants. Despite this, (SO/LA2) looks like being overspent by about £17.1m in 1983-84 and, according to the normal rules, I expect that cash limit to be abated by a like amount in 1984-85.

In anticipation of the need for abatement I retained a reserve of about £21m when completing my final allocations. Capital allocations to housing authorities will thus, even with the £17m abatement, be a few £m less than my cash limit. The other factors creating uncontrollable problems in England and Wales do not apply in Scotland. We do not allow the use of accumulated receipts, allocations are 100% net, and we have strictly limited carry over provision which we in any case allow for in our allocations within the cash limit. The net effect of all of this is that unless local authorities act 'ultra vires' I will not overspend on my SO/LA2 cash limit for this year. Given the very harsh, unpopular and politically difficult decisions which I took last autumn and earlier this year to achieve this position, I was pleased to note that you apparently see no reason to include Scotland in your proposed moratorium. I, of course, wholeheartedly agree that this would be unnecessary.

Nevertheless, I am anxious that you should not because of this position, under-estimate the very high cost at which I have secured this position in Scotland. The tremendous surge in improvement grant expenditure last year, and the reimposition of cash limit controls on it, meant that I had to impose an effective 18 month moratorium on such expenditure by telling local authorities that their consent for 1984-85 would allow for expenditure only on commitments entered into on or before 20 October 1983. On local authorities own housing capital expenditure I was only able to allow, in my allocations, sufficient to cover commitments of authorities as at 31 March. The effect of this has been virtually to stop new house build in the public sector, provision being sufficient only for essential modernisation and improvements. The pressures which these draconian measures are creating are of the utmost severity, and are giving rise to a position vis a vis housing authorities which is becoming increasingly difficult to sustain.

I am copying this letter to the Prime Minister, Willie Whitelaw, Leon Brittan, Keith Joseph, Nicholas Edwards, Patrick Jenkin, Norman Fowler, Norman Tebbit, Tom King, Nicholas Ridley and Grey Gowrie, and to Sir Robert Armstrong.

Yours ever,

George

CC NO

Prime Minister (1)
CST has proposed a moratorium to Mr Jenkin and Mr Edwards. He is likely to report to you after the meeting referred. Nevertheless you might like a word at tomorrow's meeting
AT 2/7

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Patrick Jenkin MP
Department of the Environment
2 Marsham Street
LONDON
SW1P 3EB

29 June 1984

Dear Secretary of State

LOCAL AUTHORITY CAPITAL OVERSPENDING

I am appalled by the news in your letter of 22 June about the prospects for a massive overspend in 1984-85 on the cash limit for Local Authority capital. We must certainly discuss your problem very quickly, to find a way of retrieving the situation.

- with AT

I had heard from my officials about your serious overspend for 1983-84, and was most concerned about that because forecasts during the year had suggested a major underspend. On the basis of these forecasts I and my officials agreed to several concessions during the year, for example the issue of supplementary allocations in January this year. I also agreed to your proposal to transfer £15m to the cash limit for the Urban Development Corporation. When I agreed to this you did of course undertake to take such steps as would be necessary to deliver the reduced cash limit. We must ensure that in future the information system enables you to fulfill such undertakings, by giving proper early warning of problems.

But the unforeseen outturn for 1983-84 pales by comparison with the figures you are suggesting for 1984-85. You will be aware that our Budget forecasts implied that the Reserve would be fully spent; and you will of course know of the pressure from your Local Authority current spending. I am sure that you are also aware of other problems giving rise to potential claims on the Reserve, some of which may be unavoidable. You suggest that there will be political difficulties in restraining Local Authority capital spending. But I fear that we will have to face up to those political difficulties, because you will understand that I cannot acquiesce in the extra pressure on public expenditure implied in such a major breach of your cash limit.

Turning now what could be done to restrain spending, it seems to me that in order to minimise the you will need to act quickly to announce a moratorium on new contractual commitments. From Nicholas Edwards' letter of 20 June, this appears to be necessary in Wales as well. (I am copying this letter to him). I understand that you have no figures for how much is already committed. You will need to seek this information from Local Authorities when you announce the moratorium, as Nicholas Edwards did last December. This would enable us to judge whether any easement for individual projects could be permitted later in the year.

We should accompany this action with urgent action to change the present capital controls system to ensure that this kind of problem does not occur again. What I have in mind is to move closer to the Scottish system on use of receipts, and to tighten up on borrowing, but I would welcome your views on this. I propose that we should ask officials to advise urgently on what can be done to change the system in time for 1985/86.

In view of the need for speed, rather than wait for a Cabinet Committee meeting, I would suggest that you and I meet quickly with Nicholas Edwards to discuss this and consider urgent action.

I am copying this letter to recipients of yours.

Yours sincerely
JSI. Grew

f. PETER REES

[Approved by the Chief Secretary]

/24

Local Govt reports

PENO

2 MARSHAM STREET
LONDON SW1P 3EB

01-212 3434

My ref:

Your ref:

22 June 1984

Dear Peter,

LOCAL AUTHORITY CAPITAL EXPENDITURE

I have seen Nick Edwards' letter to you of ~~20~~ June on this subject. My officials have already warned yours of the overspend of some 10% (£300m) on the 1983/84 DOE/LA1 cash limit - capital expenditure by local authorities in England. This is still a provisional figure.

I now have the first, and highly provisional, analysis of results of the three quarters of returns from English authorities to our capital estimates survey (CER) for 1984/85. The figures point to an overspend of somewhere between £½bn and £1½bn on the existing 1984/85 LA1 cash limit of £2453m. The range is wide not only because so many returns are still outstanding but also because a very large proportion of the total represents exaggerated estimates of what local authorities could in practice achieve. We have no previous survey by which to judge the returns. Moreover, unlike Wales, the estimates survey for England contains no information either about the extent to which authorities have already entered into contractual commitments, which would be exempt from any action we might take, or about the position in respect of individual services. The evidence on 1984/85 is therefore tentative. But until we have the hard evidence on spending which will begin to emerge with the first quarter's returns, we must assume that some overspend seems likely.

When the local authority capital expenditure control system was introduced in the 1980 Act, it was recognised that the cash limit would not be subject to precise control. The resources legitimately available to individual authorities to spend in any one year, especially from capital receipts accumulated in previous years, greatly exceed in aggregate the national cash limit figure. I have no reason to believe that individual authorities are proposing to exceed the resources available to them. Indeed, by making fuller use of their own resources they are responding to strong Government exhortation in the past, given in the light of the 17% (£529m) underspend on the cash limit in 1981 and the 26% (£870m) underspend in 1982/83.

The precise reasons for the overspend in 1983/84 and a prospective overspend this year are not fully clear yet. We know that there was a surge in gross expenditure in the last quarter of 1983/84. Important contributory factors are:

i. housing improvement grants: the initiative taken, at the Treasury's behest, to allow authorities unlimited additional allocations above an indicative figure for 1983/84, must have played a major part. Indications are that authorities spent £900m last year on such grants. This is £400m more than we assumed before the initiative was announced. Your predecessor accepted at the time that this represented a threat to the limit - see Leon Brittan's letter of 22 November 1982 to John Stanley. There has been a substantial carry-over of commitments on improvement grants into the current eyar, perhaps around £300m. I fully agree with the points that Nick Edwards makes on this subject in his letter of 20 June;

ii. other incentives were given, with Treasury agreement, to encourage local authorities to incur expenditure before the end of 1984/85, including the reductions in the prescribed proportion of capital receipts which in practice took effect from 1 April 1984;

iii. local authorities understand better the working of the system, and are given confidence to spend by their substantial accumulated capital receipts;

iv. Government encouragement to use the capital resources available - the local authorities and construction industry, both now apprehensive that we may take action to curb capital expenditure, are drawing particular attention to the Prime Minister's speech in the Debate on the Address and her letter to the leaders of the local authority associations in November 1982.

I should welcome an urgent discussion about the situation with you and those colleagues concerned, perhaps in H Committee. I must warn at the outset of the huge political backlash we shall face if we now take action to curb local authority capital spending.

First, local government would argue strongly that the only action appropriate on the overspend would be to set it against the underspending which occurred in the two previous years' operation of the system. They would make great play of the fact that much of their expenditure is being financed from their own receipts, following Government encouragement to sell assets and thus generate resources for additional capital spending. They would point out that the fault lies not with them but with the national capital control system. Moreover, any action would come on top of a series of major disagreements with the whole of local government. We should avoid another if we can.

Second, any action to limit local authority capital spending would have a very damaging effect on the construction industry and on employment. The hostility of the industry has already been strongly aroused by those of our recent measures, notably the imposition of VAT on alternations, which will have the

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effect of restraining demand. Moreover, the industry has a lot of spare capacity - and its workload has on the latest figures shown a downturn (1%) on the previous quarter, seasonally adjusted.

Third, we need investment in infrastructure and have said so in the past. We are coming under growing pressure from a whole range of sources - CBI, FCEC, BRF, and others - to increase capital spending on the infrastructure. We would also face the charge that to put a mid-year brake on capital spending would damage the cost effectiveness of local authority programmes, planned over a period of years.

I recognise of course that there is an interaction between local authority capital spending and the PSBR. But we must be quite clear that any action we took to curb such spending would be exceedingly difficult to present to the public. First we had a housing moratorium in 1980/81. Then we switched to urgent encouragement to spend, and in 1982/83 we primed the pump to bring about more spending. Now in 1984/85 we would be trying to turn off the tap. All of this would be presented by our opponents as a reversion to the stop-go policies practised by our predecessors. Our action would be open to ridicule, would cause dismay to our friends, and could be politically damaging in the longer term. We should also be clear that the evidence on 1984/85 is tentative. To take action too early would expose us to the criticism that we were panicking before it was at all clear whether an overspend would in practice occur.

It is evident that the operation of the capital control system as a whole is defective. The heart of the problem lies in the annual basis for the system. Whatever we decide for this year, we shall need to look again at the system, in consultation with the local authority associations which are preparing representations on the issue.

I agree fully with Nick Edwards that we must behave consistently in respect of England, Wales and Scotland. This points up the need for an early discussion.

I am copying this letter to the Prime Minister, Willie Whitelaw, Leon Brittan, Keith Joseph, George Younger, Nicholas Edwards, Norman Fowler, Norman Tebbit, Tom King, Nicholas Ridley and Grey Gowrie, and to Sir Robert Armstrong.

Yours ever

Patrick

PATRICK JENKIN

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20/6

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From The Secretary of State for Wales

The Rt Hon Nicholas Edwards MP

20 June 1984

Dear Peter

LOCAL AUTHORITY CAPITAL SPENDING IN WALES

My officials have now completed their analysis of the capital expenditure out-turn data for 1983/84 and the forecasts we asked local authorities to submit in respect of the present financial year. While the figures for 1984/85 need to be interpreted with considerable care, the picture which emerges is an interesting one and potentially very damaging from a political point of view.

The data for 1983/84 indicates that the cash limit (WO/LA1) will be overspent by £6 million or so in that year. Under the usual convention this amount will have to be deducted from the 1984/85 cash limit.

For 1984/85, our local authorities forecast gross expenditure in the year of £396 million, approximately £50 million higher than the level which would be consistent with the revised cash limit. The problem is, however, compounded by the fact that their initial forecast of capital receipts, at £71 million falls short of the PES allowance by £38 million. Thus, on the basis of the local authorities' own figures, forecast net expenditure is £325 million, £94 million above the local authority element of the revised cash limit.

Our experience in Wales indicates that local authorities' early forecasts of spending are highly optimistic, and of receipts, pessimistic. We have therefore carefully examined the elements of the local authority forecast in the light of previous years' data and our knowledge of what is happening at the individual authority level. We have also discussed the figures with the local authority association representatives on the joint Working Party on Capital of the WCCLGF. Following all this our best estimate is that if no action is taken the excess over the cash limit will be of the order of £50 million (18%).

/The source ...

The Rt Hon Peter Rees QC MP
HM Treasury
Parliament Street
London SW1P 3AG

The source of the excess appears to lie in the district tier, where we seem to have a problem with both Housing and "Other Services". The major part of it is Housing. You will remember that I warned you last autumn that the 90 per cent renovation grant initiative launched by Treasury Ministers was likely to leave us with a very large overhang when the scheme ended on 31 March. In fact, at that point, Welsh districts had 71,000 applications on hand. Allowing for withdrawals at the historic rate the cost of eliminating this backlog will be of the order of £200 million. This puts us in an extraordinarily difficult political position. Authorities friendly to the renovation grant policy will seek to eliminate their backlog by effectively using accumulated receipts which puts inevitable pressure on the cash limit (I return to this below). Unfriendly authorities will do little or nothing to tackle their backlog, putting the blame squarely on the Government for not making available the resources necessary to honour the consequences of its actions. There is simply no room to augment the Housing capital provision from within my own block which is under severe pressure, and so I am faced with the choice between honouring our policy commitment with the consequence of a cash limit breach or reneging on our commitment in the interests of preserving the cash limit.

It is important to note that the use of accumulated receipts to augment allocations is entirely permissible within the control system. The only limitation is the "prescribed proportion" which we specify in Regulations before the start of each financial year. In Wales we have already reduced this proportion to 25 per cent in the case of Housing (which accounts for the bulk of la receipts in Wales). That leaves our authorities free to apply about £100 million each year if they so wish.

I think we need to ask ourselves precisely what are our policy priorities. If it is the case that the level of the PSBR (and thus the LABR as a major component of it) is a paramount consideration we have to recognise that our policies (most immediately the renovation grant one) must be aborted if they are successful beyond our initial expectation. It is also essential, in my view, that we should further restrict the freedom of authorities to use their accumulated receipts. For my part I would prefer that action to be coupled with a more balanced approach to the continuation of policies to which we are all otherwise committed.

Unhappily our 1984/85 Housing problem is made worse by a forecast shortfall in housing receipts. The £98 million included within the cash limit for these receipts was based upon the assumption that the Housing and Building Control Bill would come into force at the start of the present financial year, and that it would generate 1,500 additional RTB sales during the course of the year. The Bill will not now, of course, come into effect until the end of July at the earliest, and will not have as significant an impact on the level of RTB activity in 1984/85 as we had expected. In addition, a recent detailed survey by my Department has revealed an over-estimation by the local authorities of the number of 'live' RTB applications outstanding at the beginning of the present financial year by about 2,500. When combined these two factors reduce the potential level of receipts in the year by over £20 million. An off-set against next year's cash limit of this magnitude would again raise the question of precisely what it is we are about, for it would necessitate deliberate and highly visible cuts in my programme.

/Any action ...

Any action in the current year to counter the danger of an overspend should in equity be aimed at the district tier, and make use again of the device of a voluntary limitation backed by the sanction of reduced allocations in the following year for those authorities who do not co-operate. Such action would not be without its own political difficulties: if we are right in our estimate of the £50 million excess, the resulting out-turn would mean that gross spending would be in cost terms some 14 per cent below the level of last year and 2 per cent below the level in 1982/83. We would have to present that as still being excessive expenditure, at a time when our opponents have a fair idea of the renovation grants overhang.

I do not have any estimates of the 1984/85 position of local authority capital spending in England or Scotland. However, I understand that in England there is a prospect of a very substantial overspend which could be at least as serious, in terms of the percentage over-spend against the cash limit, as that in Wales. Against this background I think we have to discuss with colleagues collectively the issues I have raised in this letter. It may be that H Committee would be a suitable forum. We must know where we are going and be satisfied that our actions are consistent. It is clearly essential that we should all take equivalent action if overspends do emerge elsewhere and so I would like Patrick Jenkin and George Younger to subscribe to a common approach.

We shall need to clear our minds quickly. If action is to be effective it will have to be taken by mid-July; data in respect of Wales clearly indicates that leaving the decision any later could well mean that commitments would have accumulated to the level of the present cash limit.

I am copying this letter to the Prime Minister, Willie Whitelaw, Patrick Jenkin, George Younger and Sir Robert Armstrong.

Yours ever

Nick