

Prime Minister

I commend Oliver Letwin's note summarising the position and offering a compromise

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AT
19/11

PRIME MINISTER

Local Authority Capital Expenditure

(E(A)(84)61 and 62)

BACKGROUND

Twice this year E(A) has discussed prospective overspends for 1984/85 on the cash limit for capital expenditure by local authorities

FLAG A (E(A)(84)18th Meeting, Item 1 and 22nd Meeting, Item 2). The difficulties arose because, as the system of capital allocations and public expenditure accounting stands at present (in England and Wales; Scotland is different), it is possible for local authorities in aggregate to exceed the national cash limit very significantly even if no individual authority spends more than its allocation.

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2. E(A)(84)18th Meeting invited the Secretary of State for the Environment, in consultation with the Secretary of State for Wales and the Chief Secretary, Treasury, to arrange for officials to advise on how systems of monitoring and control could be improved.

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3. The present system is described in paragraphs 2 and 3 of E(A)(84)61. Its main features are as follows.

a. The public expenditure totals, and the corresponding national cash limit, are net figures; they are gross capital expenditure less receipts during the year.

b. Each local authority receives a gross allocation, which is a legally binding limit on capital expenditure, subject to certain flexibilities. The main flexibilities are that each authority may spend a proportion (the "prescribed proportion") of receipts accruing in the year; that it may spend a proportion of receipts accumulated in past years; that certain minor "non-prescribed" expenditure is not controlled; and that there is some end-year flexibility.



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c. The total of gross allocations is calculated by adding to the net cash limit expected receipts during the year and deducting the "prescribed proportion" of those receipts and estimated non-prescribed expenditure. No deduction is made on account of potential spending financed by accumulated receipts.

4. These features have the consequence that the national cash limit may be exceeded, even though no local authority spends more than it is allowed: in particular, the estimate of in-year receipts may be too high; and no account is taken of spending from accumulated receipts. It would be technically quite easy to change both these features. But doing so would have the effect of reducing total allocations to authorities: spending Ministers wish to keep the total fairly high, so that it is easier to match allocations to needs.

5. The fact that an authority can use about half its accumulated capital receipts but that such receipts are not taken into account at all in making allocations makes it theoretically possible to have a very large overspend above the national cash limit. Since accumulated capital receipts are estimated at around £6 billion, the theoretical overspend could approach £3 billion.

6. The arrangements now proposed by the Chief Secretary, Treasury are described in paragraphs 5-7 of E(A)(84)61. The effect would be to achieve a much closer match between authorities' total spending power and a gross expenditure target set by the Government. This would involve bringing the use of accumulated capital receipts newly into control in relation to gross expenditure. The Chief Secretary says he would be prepared to allow for some slack (he suggests £50 million) to remain in the system to guard against major underspends. The Chief Secretary proposes (paragraph 12 of E(A)(84)61) a "prescribed proportion" of 15 per cent, which compares with prescribed proportions at present of 40 per cent (in England) for housing receipts and 50 per cent for other new and accumulated receipts.

7. These arrangements are based on proposals made by the Secretary of FLAGD State for Wales in a letter dated 2 November to the Chief Secretary, but

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the latter's figures leave rather less flexibility in the system than it seems the Secretary of State for Wales might have wished to see. Other recent correspondence is summarised at the Annex to this brief.

Page E 8. The Secretary of State for the Environment says (E(A)(84)62, paragraphs 5 and 6) that the Chief Secretary's proposals would be politically unacceptable and would have very drastic effects, reducing spending limits for some authorities below their commitments. He points out that, if accumulated receipts were brought into control on the basis proposed, arrangements retaining some appearance of access to them would be more cosmetic than real. While accepting a reduction in the prescribed proportion of new and accumulated receipts for housing (though not of receipts of other kinds), plus other adjustments to compensate for "non-prescribed" items, he proposes that allocations (presumably either individually or in aggregate) should not be specifically reduced to take account of spending power arising from accumulated receipts. He proposes also that the Government should announce now that it will take no further action on capital spending in the course of 1985/86. He proposes further that 5 per cent of each service block should be held back at the outset of the year, but distributed later to supplement the allocations of authorities which comply with the requirement for restraint.

9. For 1986-87 and later years the Chief Secretary proposes that officials should do further work, and that consultations with local authority associations should continue. These proposals seem likely to be acceptable to other Ministers.

MAIN ISSUES

10. The main issue before the Sub-Committee is what changes, if any, should be made in the system for 1985-86. It will probably be convenient to consider two aspects:

- i. to what extent should account be taken of accumulated receipts?



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ii. should the "prescribed proportion" of in-year receipts be reduced?

It will also be necessary to confirm that the Chief Secretary's proposals for 1986-87 and later years are acceptable.

Accumulated receipts

11. The Secretary of State for the Environment rightly says that the fundamental point on which he differs with the Chief Secretary is whether allocations should be reduced in respect of accumulated receipts. It is undeniable that accumulated receipts account for most of the slack which exists in the system at present. The Chief Secretary's argument is that the capital expenditure cash limit should be treated as strictly as any other. The Secretary of State for the Environment, however, argues that this cash limit is special because of the major role of receipts in financing local authority capital expenditure and the stress laid on that role by the Government in the past.

12. The Sub-Committee seem likely to agree that in future the system will have to take some account of accumulated receipts: the risk of excessive expenditure financed by an accumulated £6 billion of receipts is clearly very high. There is no need to prevent authorities from using these receipts, but rather to take their possible use into account in deciding the total of allocations. The Sub-Committee may also find unpersuasive the apparent implication in the statement at paragraph 6.d. of E(A)(84)62 that the Chief Secretary's proposal "would bring about a much more drastic reduction in the total level of capital expenditure next year than I believe colleagues thought they were agreeing to in our recent decisions on provision". It was clear during the recent public expenditure discussions that there was an outstanding remit to the Chief Secretary and Secretary of State to find ways of tightening controls within the system.

13. On the other hand, the Sub-Committee may find the Chief Secretary's proposals too restrictive. As the Chief Secretary himself recognises, if

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the potential spending from accumulated receipts is taken 100 per cent into account in deciding the total of allocations, there is likely to be underspending, because not all authorities will make full use of their spending power. The Chief Secretary offers an addition of £50 million to offset this; but spending Ministers may well consider this inadequate.

14. There is a further point to be taken into consideration. The more account is taken of accumulated receipts, the smaller the total of gross allocations must be, and the more difficult spending Ministers will find it to match allocations to need. On the other hand, if the ability of authorities to use accumulated receipts is greatly reduced, there will be accusations of bad faith.

15. These are perhaps rather detailed matters for discussion in full Sub-Committee. But it would be helpful if the Sub-Committee could give guidance on the following questions.

a. Roughly how much 'play' should there be in the system? About the £50 million proposed by the Chief Secretary or something significantly larger?

b. Should the 'play' be created by setting a low "prescribed proportion" for accumulated receipts and largely ignoring them in deciding total allocation, or by setting a fairly high "prescribed proportion" and taking significant account of these in deciding total allocations?

In-year receipts

16. The Chief Secretary proposes that the "prescribed proportion" of in-year receipts should be reduced. This has the somewhat perverse effect of increasing the likely overspend due to a shortfall in receipts (every pound of shortfall in receipts adds a pound to net expenditure but reduces spending power by only the "prescribed proportion" of one pound). But it increases the permissible total of gross allocations. Do the Sub-Committee think this trade-off is acceptable?

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Future years

17. There seems little point in the Sub-Committee seeking to reach conclusions now on detailed arrangements for future years. It will be possible to consider this further when the practical implications of decisions for 1985/86 and the nature of their reception by local government are clearer. Moreover, the Secretary of State for the Environment has recently begun to consult local authorities on the future of the control system and it would be undesirable to appear to prejudice the conclusions either of this consultation or of the further study currently being undertaken by the Audit Commission.

Other matters

18. The Secretary of State for Wales has proposed a way of using borrowing controls in combination with spending controls to ensure that accumulated receipts in the system are spent up over a number of years and do not continue to grow. He originally envisaged this from 1985/86, but in his letter of 16 November has now agreed that this question should be further examined in relation to 1986/87 and future years, as proposed by the Secretary of State for the Environment and the Chief Secretary. He is also now prepared to accept the Chief Secretary's proposal for end-year flexibility of 5 per cent but has asked that this should be a tolerance both ways, rather than just a carry-over of underspend.

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19. The Secretary of State for the Environment proposes announcing now that the Government will take no action on local authority capital expenditure in the course of 1985/86. It might be unwise to circumscribe the Government's freedom of action in this way, particularly if the Sub-Committee decides either to leave accumulated receipts largely outside the control system, as proposed by the Secretary of State for the Environment; or to bring them into control in relation to gross spending but within a control total which provides for a substantial amount of slack to remain in the system for next year. Such an announcement might be safer (and perhaps useful presentationally), however, if the Sub-Committee decides on stringent controls as proposed by the Chief Secretary.

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HANDLING

20. You will want to invite the Chief Secretary and Secretary of State for the Environment to present their papers and the Secretary of State for Wales to comment. The Home Secretary and the Secretaries of State for Social Services, Education and Science and Transport will have views as Ministers responsible for local services involving capital expenditure. The Paymaster General will have views on the politics and presentation.

CONCLUSIONS

21. You will wish to reach conclusions on the following:

i. ^{*deduct for*} should accumulated capital receipts be taken into account to ~~some extent in setting~~ the total of allocations (as the Chief Secretary proposes) or not at all (as the Secretary of State for the Environment argues)?

ii. broadly how much 'play' should there be in the system (ie the maximum theoretical national overspend, bearing in mind that actual overspend is likely to be much less in practice)?

iii. what guidance does the Sub-Committee wish to give on how this amount of 'play' might best be achieved in respect of accumulated receipts:

a. by fixing a low "prescribed proportion" of receipts but ignoring them in setting the total of allocations; or

b. by fixing a higher "prescribed proportion" of receipts but taking them into account to some extent in setting a total of allocations;

iv. should any change be made in the "prescribed proportion" of in-year receipts?



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v. whether end-year flexibility should be increased to 5 per cent both for individual authorities and for the national cash limit, and whether it should be a tolerance both ways (as the Secretary of State for Wales would prefer) or a carry-over of underspending only (as proposed by the Chief Secretary)?

vi. should work on 1986/87 and future years go ahead as proposed?

vii. the content and timing of any announcements.

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19 November 1984

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SUMMARY OF RECENT CORRESPONDENCE ON LOCAL AUTHORITY
CAPITAL EXPENDITURE CONTROLSChief Secretary, Treasury to Secretary of State for the
Environment, 19 October

Proposes ensuring the spending power of local authorities does not exceed cash limit and expected in-year receipts. Proposes alternative ways to do so by controlling use of accumulated receipts and other flexibilities with reference to gross expenditure target. Government to help local authorities within more effective control system by extending forward indications now given of some allocations; reviewing remaining project controls; and changes to end-year flexibility.

Secretary of State for the Environment to Chief Secretary,
Treasury, 25 October

Chief Secretary's proposals for cutting off use of accumulated capital receipts immensely controversial, would cause havoc to authorities' plans for 1985/86 and lead to chronic underspending in later years. Folly to embark on further major confrontation with local government, particularly since consultative process with local government underway and report by Audit Commission pending. Authorities would need to use receipts accumulated over past few years in lean years ahead: problem of accumulated receipts would automatically unwind over this period. For 1985/86, present system should be basically retained. For future years, variation should be considered on past system of controls through borrowing approvals.

Secretary of State for Employment to Chief Secretary,
Treasury, 31 October

Allowing access to proportion as low as 10 per cent of accumulated receipts in any one year would be seen as major breach of faith by Government's supporters. Use of accumulated assets key to encouraging authorities to accelerate council house sales and dispose of surplus land and assets.

Secretary of State for Transport to Chief Secretary,
Treasury, 1 November

Concerned both about ineffectiveness of present system and political and practical difficulties of tightening up. Danger of stop-go, leading to underspending in later years. Tightening controls as suggested by Chief Secretary would in practice amount to further cut on top of reductions agreed in bilaterals. This unacceptable. For 1985/86, should consider some reduction in prescribed proportion of receipts, but no reduction in allocations to offset end-year flexibility.

Chief Secretary, Treasury to Secretary of State for the
Environment, 2 November

Withdraws proposals of 19 October. Hopes to put forward revised proposals shortly.

Secretary of State for Wales to Chief Secretary, Treasury,
2 November

Present mechanisms not operating successfully, but with programmes so wide-ranging, complex and remote in terms of operational control, more realistic approach to seek to ensure that net capital spending falls within acceptable range - say 10 per cent - either side of the target. End-year flexibility should be 10 per cent locally and nationally. Forward indications should be raised to 90 per cent for last two years of survey period.

Proposes controls by starting from gross expenditure figure underlying target for net expenditure. From that figure, total for allocation to be arrived at by deducting prescribed proportion of all receipts (accumulated and in-year) together with allowance for non-prescribed expenditure. Ensure that problem of accumulated receipts unwound by ensuring that borrowing approval did not exceed target for net expenditure. Will give further views after meeting with Welsh Consultative Council on 12 November 1984.

Secretary of State for Transport to Chief Secretary,
Treasury, 7 November

Supports Secretary of State for Wales' proposals for 1985/86. Will write with own thoughts on future years shortly.

Paymaster General to Chief Secretary, Treasury, 8 November

Sympathetic to concern about capital spending by local authorities. But stringent action restricting access to accumulated receipts likely to put Government at loggerheads with many of own supporters.

Secretary of State for Education and Science to Chief
Secretary, Treasury, 9 November

Share determination for effective control system but further work and consultation with authorities needed. For 1985/86. deductions in respect of end-year tolerance and "non-prescribed"/^{expenditure}from total sum to be distributed unacceptable as reducing resources below level agreed for education capital expenditure at bilateral. Arrangements proposes for access to accumulated receipts would restrict discretion in making allocations on criteria of need.

Secretary of State for the Environment to Chief Secretary,
Treasury, 9 November

Decisions for 1985/86 urgent to allow capital allocations to be issued in December. Proposes to stick close to present regime for 1985/86, though prepared to see modest reduction in prescribed proportion for housing receipts. Continue to look at improvements for subsequent years, in light of consultations with local authority associations.

Secretary of State for Wales to Chief Secretary, Treasury,
16 November

Prepared to accept Chief Secretary's proposals, subject to: 5 per cent tolerance both ways; modifications to the "prescribed proportions" of receipts; and certain other provisos.

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From the Minister

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20 November 1984

with AT?

LOCAL AUTHORITY CAPITAL EXPENDITURE

I have read your memorandum of 15 November setting out proposals for improving controls over local authority capital expenditure in 1985-86 and beyond. I understand that this is to be discussed in E(A) on Tuesday 20 November when I shall be unable to attend.

As you know my direct interest in local authority capital expenditure is small and the proposals set out in E(A) (84) 61 would not appear to have any significant repercussions for the expenditure plans we have already agreed for land drainage and flood protection, smallholdings and fisheries harbours. On a wider front, overspending by local authorities is clearly a matter of some concern and one that we must remedy if we are to achieve our aim of holding public expenditure to plan. But in seeking improved controls I think we must be careful to ensure that whatever we agree both for 1985-86 and eventually for the longer-term minimises any risk of overkill, and hence unnecessary alienation of local authorities in general and our own supporters in particular.

I am sending copies of this letter to the Prime Minister, the other members of E(A), Leon Brittan, Norman Fowler, Keith Joseph and Sir Robert Armstrong.

MICHAEL JOPLING

20 NOV 1984

