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NBPM AT 26/4

Prime Minister

LOCAL AUTHORITY CAPITAL CONTROLS

I thought it would be helpful if I expanded the views I gave before I had to leave Tuesday's E(A) meeting early. I strongly support the need for the system to be tightened up but we must do so without damaging our own policies in the process.

This question is a very important one for me because transport, next to housing, is the biggest local capital spending programme. It comprises nearly a third of the total. Unlike the other main blocks its main customers are the business community. It is vital to achieving the objectives of my trunk roads programme because it provides for adequate access to the national route system. I am therefore very concerned that it should not be damaged by our decisions on capital controls.

Unlike most other programmes there is no evidence of significant transport overspend. This is not surprising as - unlike any other programme - it is almost entirely in the hands of first tier authorities who do not have access to the substantial housing capital receipts accruing from the "right to buy" policy. This underlines the need to concentrate our action on housing receipts because they are the main cause of the problem. As the attached diagram shows, these account for over 60% of the total "overhang" of authorities' right to spend over the cash limit.

I do not believe it is the size of the service allocations we give which is causing the problem. This is the difficulty with both Peter Rees' and Patrick Jenkin's proposals. They both significantly reduce the total available for service allocations. Any reduction on the already very

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tight transport total which I reluctantly accepted in the PES review will have a devastating effect. Key authorities' programmes will be disrupted in the critical year before abolition and it would cause great political problems.

We could reduce the "overhang" by much more than is achieved by Patrick Jenkin's proposals by a bigger cut in the prescribed proportion of housing receipts. We should reduce this at least down to the level Nick Edwards already uses in Wales, perhaps to the 15% Peter Rees proposes. The non-housing proportion might also be cut to 40%. This option shown on the diagram would cut the "overhang" from £2.2 billion to £1.4 billion, without squeezing the service allocation. I do not believe that an overhang of this order will pose any real threat of overspend.

Patrick Jenkin's extra allocations for authorities who restrained their spending this year would have to be made so far on in the year that they would be a receipe for poor value spending. They would be virtually no use to transport where long lead times make it quite impossible to adjust programmes significantly after the first two to three months of the year. I know this only too well from the trunk road programme despite the fact that its greater size gives much more flexibility than any County has. They would merely run the risk of overspending on those programmes which can be quickly increased. If rewards are important they would be better limited to housing authorities who have restrained their spending, financed by a deduction on the housing allocations only.

Peter Rees' proposals to deduct the prescribed proportion of accumulated receipts as well as in-year receipts could only be implemented on an arbitrary basis because accumulated receipts for each service block cannot be separately identified. Some formula allocation would have to be made - presumably pro rata to past shares of receipts.

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I appreciate that a big cut on prescribed housing receipts will be very unpopular and seen as a breach of faith. But it has already been pointed out that the main engine driving the increase in housing receipts has not been authorities' incentives to sell them, but individuals' desire to purchase their council houses. I doubt, therefore, that tightening up on housing would have a significant adverse effect on the level of housing receipts. It is a Right to Buy. Any effective action is bound to be unpopular because the "overhang" has got so large. Clearly, we must fundamentally change the system in the longer term to prevent the possibility of such an enormous "overhang" and I hope officials can come up with some options quickly so that we can make an early announcement of what we intend.

I would have liked to attend the meeting next Tuesday under the Chancellor's Chairmanship but, as you know, I have to be in Rome on unavoidable business. I would be grateful therefore if Lynda Chalker could attend in my place in view of the very important transport implications of this issue.

I am copying this minute to the Chancellor of the Exchequer, other members of E(A), Leon Brittan, Norman Fowler, Keith Joseph, Grey Gowrie and Sir Robert Armstrong.

H C Derwent (Private Secretary)

for NICHOLAS RIDLEY (Approved by the Secretary of State but signed in his absence)
23 November 1984

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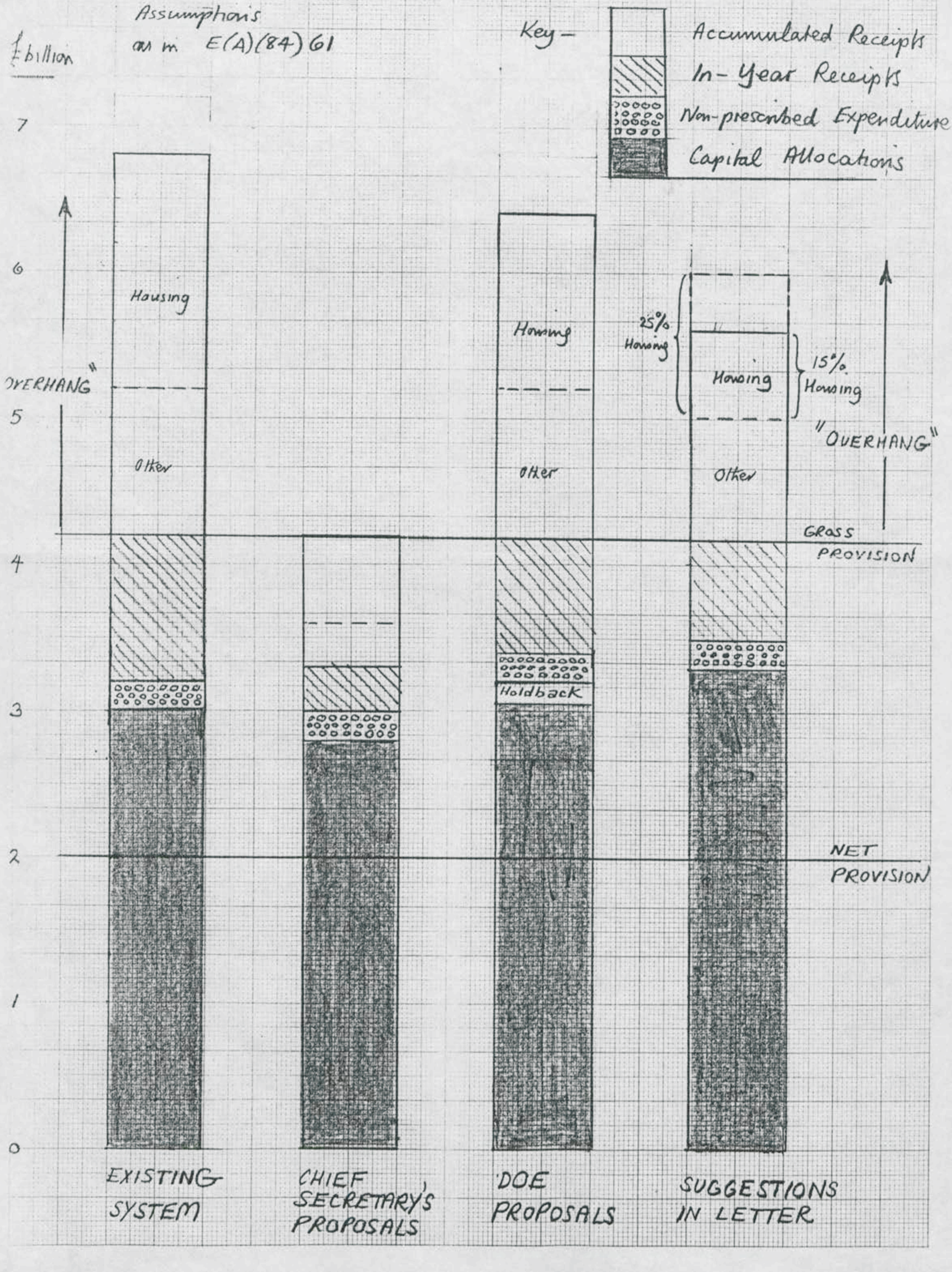
ALTERNATIVE PROPOSALS FOR CAPITAL ALLOCATIONS IN 1985/6

Assumptions as in E(A)(84)61



NBPM AF 27/11

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Patrick Jenkin MP
2 Marsham Street
LONDON SW1P 2AL

26 November 1984

Dear Secretary of State,

LOCAL AUTHORITY CAPITAL CONTROLS SYSTEM

We are to meet with other colleagues on Tuesday to devise a compromise between the proposals in E(A)(84)62, which the Prime Minister said would not be strong enough to reduce the potential overspend next year, and those in E(A)(84)61, which she thought might well be too restrictive.

I start from the fundamental principle, recognised in E(A), that it would not be acceptable to put the planning total at risk to the extent of £½ billion or more. This must mean some reduction in potential spending powers. But I accept equally that we do not want massive underspending or a breach of commitments about the total of future allocations or measures which bear hard on those authorities, especially in the shire counties, who have co-operated with us.

With these points in mind I put forward the following modification of my original proposals:

(i) If a prescribed proportion of 15 per cent is agreed, I would be willing to abate by £200m the deduction for accumulated receipts for the purpose of arriving at allocations, which would then be £700m instead of £900m. Allocations would then total (England and Wales) about £3.0bn, very close to the figure that would have resulted from the application of the present control system to the provision for 1985-86 to which we agreed in the Survey. In announcing the new total, there would be no need to explain precisely how we had arrived at it.

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(ii) I take the point that for some services, especially those (education and transport) administered by the shire counties, the accumulated receipts are relatively small. We cannot obtain precise information in the time available; but I would suggest that the aggregate reduction of £700m on account of accumulated receipts might best be divided between services in England in proportion to the estimated receipts in 1985-86 for which we allowed in the Survey. On this basis the reduction for transport would be negligible (perhaps £1 million) and that for education very small (perhaps £25 million). We could still broadly satisfy the commitments on housing and other environmental services given for 1985-86 and I would agree, if colleagues wished, to repeat these commitments with figures of 80 per cent for both forward years. For Wales I would be content with the proposals in Nick Edwards' letter of 16 November.

(iii) I am also willing to couple the 5 per cent allowance for carry-forward to unspent provision with an agreement that in-year corrective action would not be taken for prospective over-spending up to that level.

The attached table amplifies that which I handed round at the E(A) meeting, with an additional column showing my new proposals. The effect of (i) above would be to give authorities extra spending power from accumulated receipts of £200m. There are of course other potential pressures on the cash limits for which we are still making no allowance (eg the local tolerance of 10 per cent and the possibility that in-year receipts will fall short of our estimates), as well as my concession at (iii). My proposals do not mean that overspending is acceptable: rather they are designed to build some flexibility into the system to allow spending in line with our plans. We cannot afford to go further.

Finally, these decisions would of course apply only to 1985-86. For future years we should ask officials to produce proposals based on the principles in paragraph 2 of this letter, by Easter. They should also examine means of restricting borrowing approvals in order to reduce the element of doublecounting which we discussed in E(A), and take account of the consultations now in progress with the local authority associations.

I am sending copies of this letter to the Prime Minister, Nigel Lawson, Leon Brittan, Keith Joseph, George Younger and Nick Edwards and to Sir Robert Armstrong.

Yours Sincerely

Paul Pegler

PETER REES

(approved by the Chief Secretary and [illegible])

£ billion England and Wales	1 1984/5 40% pp housing 50% the rest present allocation policy	2 1985/6 Same basis	3 1985/6 Proposals in E(A)(84)61 15% pp, full allowance for acc. receipts	4 1985/6 Proposals in E(A)(84)62 30% pp housing, 50% the rest, 2½% reduction of allocations for non-compliance	5 1985/6 Chief Secretary's new proposals 15% pp, £200m abatement of deduction for acc. receipts
Net Survey	2.5	2.0	2.0	2.0	2.0
Add estimated in-year receipts	2.1	2.2	2.2	2.2	2.2
Gross provision	4.6	4.2	4.2	4.2	4.2
Deduct:-					
(i) Allowance for pp in-year receipts	0.9	0.9	0.3	0.8	0.3
(ii) Allowance for pp accum. receipts	0	0	0.9	0	0.7
(iii) Non-prescribed expenditure	0.2	0.2	0.2	0.2	0.2
Allocations	3.5	3.1	2.8	3.2	3.0
2½% Reduction				0.1	
Revised Allocations	3.5	3.1	2.8	3.1	3.0
Add					
Prescribed proportion of in-year and accumulated receipts - say	2.9	3.3	1.2	3.2	1.2
Non-prescribed expenditure	0.2	0.2	0.2	0.2	0.2
Total spending power available to local authorities	6.6	6.6	4.2	6.5	4.4
Deduct Gross provision	4.6	4.2	4.2	4.2	4.2
Spending power beyond cash limit	2.0	2.4	0	2.3	0.2

pp = prescribed proportion

PRIME MINISTER 19 November 1984

LOCAL AUTHORITY CAPITAL EXPENDITURE

A great many complicated suggestions have been put forward. The simplest way to think about the problem is this:

1. In the public expenditure round, Ministers decided to allow local authorities to spend £4.2 billion on capital projects in 1985/6. If the present system is left unchanged, this figure will be greatly exceeded in practice.

2. The main reason for the lack of control is that local authorities are allowed to spend half of the £6 billion receipts that they have accumulated from past sales, in addition to their basic allocations. This gives them scope to spend up to £3 billion over the PES target figure, with corresponding effects on net PSBR.

3. The Chief Secretary wants to reduce the scope for overspending by:

   a. allowing local authorities to spend only 15% of their accumulated receipts in 1985/6 instead of 50% - ie £0.9 billion instead of £3 billion; and

   b. subtracting even this £0.9 billion from basic allocations.

4. Nick Edwards accepts this proposal in principle, with a few detailed amendments.

5. Patrick Jenkin objects strongly. He believes that the Shire Counties and other friends of the Government will be outraged by the imposition of such a stiff limit on their use of accumulated receipts, and he also believes that a rigourous cash limit will in practice cause local authorities to underspend. He therefore proposes:

   a. to let local authorities spend 30% of accumulated housing receipts and 50% of other accumulated receipts - a total of about £2.5 billion instead of the Chief Secretary's £0.9 billion;

   b. not to subtract this £2.5 billion from basic allocations.

JMPAAV

6. Allowing for all the refinements discussed in the E(A) papers, the Chief Secretary's proposal would keep local authority capital spending very near to the PES maximum of:

£4.2 billion

Patrick Jenkin's proposals would enable local authorities to spend a maximum of roughly:

£6.3 billion

Finding A Solution

We believe that a compromise is needed, since the Chief Secretary's proposal will enrage the Government's friends, whilst Patrick Jenkin's proposal makes a nonsense of the PES decision. The Government will have to give away something, but it needs to end up nearer to the Chief Secretary than to Patrick Jenkin, since it obviously cannot afford to endanger the whole of its contingency reserve.

We therefore recommend that the Prime Minister should ask E(LA) to settle the details of a package along the following lines:

i. allow local authorities to spend only 15% of their accumulated receipts in 1985/6 (ie £0.9 billion), as the Chief Secretary wants;

ii. but, as Patrick Jenkin asks, do not subtract this £0.9 billion from basic allocations;

iii. allow authorities to spend 30% of housing in-year receipts and 50% of other in-year receipts over their basic allocations (cf Patrick Jenkin);

iv. give authorities additional flexibility by allowing them £0.2 billion of discretionary spending (cf the Chief Secretary) and permission to carry forward 5% underspending or overspending to the following year (cf Nick Edwards);

v. withdraw £0.2 billion from basic allocations for redistribution to those authorities that have obeyed this year's moratorium (cf Patrick Jenkin).

This package would allow local authorities to spend a maximum of:

£5.1 billion

JMPAAV

In practice, this would prevent the PES target being overspent by more than about £0.5 billion, but would also make some concessions to the Government's friends.

The Chief Secretary will argue that this package is too generous; but we believe that anything less will cause havoc in the Shires.

Patrick Jenkin will argue that even such a compromise will provoke loud complaints; but we believe that anything more will cause intolerable problems for the Treasury.

OLIVER LETWIN

JMPAAV

PRIME MINISTER 20 November 1984

LA CAPITAL SPENDING: THE SCOTTISH SOLUTION

It has just occurred to me that we may have something to learn from Scotland. The Scots have not suffered from the overspending that has afflicted England and Wales.

Their system is very simple: they allow local authorities to spend 100% of the receipts accruing in any given year, but they do not allow any accumulation of permissions over the years. An authority's allocation in year 2 is not affected by any receipts that it may have kept over from year 1. As a result, the Scots do not have the mountain of accumulated receipts that have caused all the trouble in England and Wales.

If E(A) cannot agree on any of the proposals currently being considered, you might suggest the adoption of the Scottish system for England and Wales. Authorities which have already accumulated receipts would have to be allowed to spend some proportion of them each year until they were exhausted - say 15%. But no new accumulations would be allowed.

Ol Letwin

OLIVER LETWIN