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cc of

Cabinet

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

LOCAL AUTHORITY CAPITAL CONTROLS SYSTEM
IN ENGLAND AND WALES, 1985-86

On 20 November E(A) invited me to chair a small group to try to work out a compromise between the proposals set out by Peter Rees in E(A)(84)61 and by Patrick Jenkin in E(A)(84)62. The other members of the group were Leon Brittan, George Younger, Patrick Jenkin, Nick Edwards, Peter Rees and Nicholas Ridley.

2. We have met twice, and moved some way towards meeting the remit we were given. But we have not in the time available been able to reach a final agreement. So I must now report to you and Cabinet colleagues where we have reached, and the compromise I have put forward as the Group's chairman.

The present control system

3. It may help colleagues to start with a description of the existing system of capital controls, and the defects in it that we all agree need to be put right. For England we make public expenditure provision for five blocks of local authority capital expenditure (housing, transport, education, personal social services, and other services) in net terms, that is after allowing for receipts. We then combine these blocks into a single cash limit. There is a separate cash limit, covering the same services, for Wales.

4. To convert these public expenditure figures, which we agree in Cabinet, into the allocations to be divided between individual local authorities we have to make an estimate of likely capital receipts. Local authorities at present have the power to spend a proportion of their receipts, as follows:-

- (a) 40 per cent of in-year housing receipts;



(b) 50 per cent of other in-year receipts ((a) and (b) combined are called the "prescribed proportions"),

5. The rest of their forecast in-year receipts, plus the net cash limit, give us, broadly, the total to be allocated between the authorities. We then allow individual authorities to spend their allocations plus 40 per cent of in-year housing receipts and 50 per cent of other in-year receipts as described above. On top of that, however, we also allow them to spend the same proportion of unspent receipts accumulated from previous years.

Need for a new system

6. We are all agreed that the system as it stands is most unsatisfactory. It permitted what would have been a massive capital overspend by local authorities this year had we not taken steps to contain it, and which, even after those steps, will be a substantial figure, perhaps £500 million. In particular, the arrangements that permit authorities to spend such a high proportion of accumulated receipts from asset sales in previous years represents a serious weakness in the system, since these accumulated receipts now stand at around £6bn.

7. We are all agreed that it is important to have a certain amount of flexibility in the system, to encourage authorities to spend up to the plans for individual services, and in total, and to achieve good value for money. We also need to retain incentives for authorities to dispose of assets. But we cannot allow a system to continue that leads to the collective cash limit being broken by substantial amounts year after year.

8. We also agree that for 1985-86 we are not looking for radical changes, but adjustments to the present system to improve control.

Proposals for 1985-86

9. For England the net cash limit for 1985-86 derived as



described in paragraph 2 above is £1.95 billion. But, largely because of the accumulated receipts from the past (particularly from housing sales), the present system of allocations - were we to continue to use it - would put this cash limit at risk to the extent of £2½ billion potential overspending.

10. Peter Rees put forward proposals that would have reduced the amount at risk to £200 million. Patrick Jenkin has proposed reductions in the prescribed proportions (to 25 per cent for *housing* and 40 per cent for all other areas) which would reduce the potential threat to £1.6 billion.

11. In an attempt to reach a compromise acceptable to all members of my group I have made the following proposal. It recognises, as I accept that we should, that authorities are not in practice likely to use all of their potential spending power.

12. I propose that for 1985-86 the prescribed proportions for different categories of receipts, including accumulated receipts as well as in-year receipts, should be as follows:-

- (a) 15 per cent for housing receipts other than housing land;
- (b) 30 per cent for housing land receipts; and
- (c) 30 per cent for non-housing receipts.

13. I believe it is right to preserve a difference between the proportions for housing and non-housing assets. In the case of housing, sales are essentially generated by the tenant's right to buy, on very generous terms and this in itself should ensure a continuing flow of receipts. For other assets, where there is no right to buy, local authorities need some extra incentive to encourage them to make disposals. In both cases, of course, the system will continue to favour those authorities that have



co-operated with our policy of asset sales.

14. This proposal would enable colleagues to issue allocations totalling just over £3 billion. I have suggested the distribution between services shown in the annex to this minute. It would:-

(i) give allocations to housing and other services in 1985-86 that are 85 per cent of those for 1984-85. Local authorities were told earlier this year to plan on the assumption that the figure would not be less than 80 per cent.

(ii) provide allocations for the other three blocks consistent with the public expenditure decisions we reached in Cabinet last month.

(iii) give Patrick Jenkin a reserve of £100 million with which to make supplementary allocations to authorities which have co-operated with this year's request for expenditure restraint.

15. These proposals would, in the worst case, where authorities used their maximum theoretical spending power, permit overspending of some of £¾ billion in 1985-86. But I accept that on a realistic estimate of the amounts authorities are actually likely to spend next year - perhaps 85 per cent of their total spending power from allocations and receipts - there should be no threat of a serious overrun of the cash limit.

16. Finally, I propose that the carry-forward of any underspending on the national cash limit from one year to the next should be to a maximum of 5 per cent of the cash limit instead of the present 2 per cent. Peter Rees accepts that we should tell local authorities that we would take no in-year action to restrain spending in 1985-86 if the forecast overspend at the national



~~level~~ did not exceed 5 per cent of the cash limit. Beyond this point, and as a confidential agreement between the Ministers concerned, Peter Rees is also prepared not to press for in-year action unless there were a significant risk of an overspend of more than 10 per cent of the cash limit, provided there were no need for more general measures to restrain public expenditure. Any overspending would of course be deducted from the provision for a subsequent year.

16. Both Keith Joseph and Nicholas Ridley have told me they are broadly content with these proposals. Agreement has also been reached with Nick Edwards, who is to have a prescribed proportion of 15 per cent for housing receipts and 50 per cent for non-housing receipts, and allocations of about £265 million - a level which should prevent overspending of more than about £10 million. I regret, however, that Patrick Jenkin has not felt able to agree.

17. Nevertheless, I believe that the proposals meet the criteria we set out to achieve, and that they represent a fair and reasonable compromise. They reduce, without eliminating completely, the threat to next year's cash limit; retain, a worthwhile incentive to secure capital receipts while smoothing out their use over time; provide allocations for services which, supplemented by those receipts, are consistent with our decisions on public expenditure last month; and, by reducing the likelihood of the need for in-year action of the kind we had to take this year, would enable local authorities to plan in a more securely based and cost-effective way.

18. I therefore commend these proposals to Cabinet. I also suggest that we ask officials to report to us by Easter on the changes that might be made in the system for subsequent years.

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]9. I am sending copies of this minute to other members of the Cabinet, the Paymaster General and the Chief Whip, and to Sir Robert Armstrong.

N.L.

PP

N.L.

11 December 1984

*(Seen and approved by the Chancellor,
and signed in his absence)*

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ANNEX

ALLOCATIONS 1985-86: ENGLAND

Housing	1576	1670	+ 94.
Other services	320		
Education	325		
Transport	640		
Personal social services	70		
Supplementary allocations	100*		
	<u>3031</u>	3125	

*For those authorities which comply with the request for restraint in 1984-85.

85% of allocations
this year.



10 DOWNING STREET

From the Private Secretary

Prime Minister

Olive's note makes it clear that to settle La Capital Spending, it is essential to start with a view on what potential and actual overspend one is prepared to tolerate. Having close that it is easy to ^{set} the parameters such as the prescribed proportions which will achieve that result. Previous discussions have got in a mess starting with the details. Olive takes the view that even Chancellor's package, with perhaps £250 million of actual overspend is unscaleable, but that you should open the bidding for any relaxation as low as possible.

P.S. Will reducing the proportion of housing receipts authorities can keep jeopardise the extra receipts Mr Jenkin is seeking?

AT

12/12

Cash points

5 years

£ 6 billion
2 billion

overhang

£ 4 billion
in cash

PRIME MINISTER

12 December 1984

85-86

overspend
£ 1/2 billion

£ 1/2 bn 1.3

LOCAL AUTHORITY CAPITAL SPENDING

£ 2 billion

This year, despite the voluntary moratorium, local authorities will have spent about £5 billion on capital projects.

Pes.
4.27 C.S.

The Cabinet's PES provision allows them to spend only £4.07 billion next year - a cut of more than £900 million.

1/3 has gone
£ 1 bn gone
by L.A.'s

The Chancellor's new package allows them to spend £4.8 billion next year - a potential overspend against PES of over £700 million, but still £250 million less than this year.

4.8
£ 1.50m
£ 1.6bn
£ 5.6

Patrick Jenkin's proposal allows them to spend £5.7 billion next year - a potential overspend against PES of £1.65 billion, and £700 million more than this year.

Nobody is sure how much of the potential overspend will actually occur: Patrick Jenkin is more optimistic than the Chancellor. We agree with the Chancellor's pessimism: one has to assume that local authorities will spend almost up to capacity in a year when the régime is very tough.

£ 1.6bn
80%
800
100
1.3bn

What to do?

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We do not believe that the Chancellor's proposal is politically feasible. If the Government asks local authorities to spend £250 million less on capital projects next year than this year, it will face a revolt in the Lords.

But Patrick Jenkin's proposal would probably result in an actual overspend of about £1 billion, which would demolish the Chancellor's Contingency Reserve.

£ 5 bn

We therefore suggest that you adopt one of two compromises:
either:

- 15
8
- i. allow local authorities to spend £5 billion (the same as this year in cash terms), by raising the housing 'prescribed proportion' from 15% to 20%, whilst retaining the rest of the Chancellor's package; (this would lead to potential overspending of about £1 billion and might result in actual overspending of about £250 million);

or:

- ii. allow local authorities to spend £5.25 billion (the same as this year in real terms) by raising the housing 'prescribed proportion' from 15% to 25% whilst retaining the rest of the Chancellor's package; (this would lead to potential overspending of about £1.25 billion and might result in actual overspending of about £500 million.

We believe that either of these proposals might win Parliamentary approval, though neither is certain to do so. It might be better to start with the less 'generous' (£5 billion) solution, so that the more 'generous' (£5.25 billion) option is available as a last-minute concession if it proves necessary.

We suggest that you should keep the discussion on the aggregates rather than the details; but in case there is reference to detail, we attach an Annex giving the relevant figures in simple tables.

Oliver Letwin

OLIVER LETWIN

Local Count: Relations Pt 24

PES: 1985/86

	<u>£ billion</u>
Net provision	1.95
Estimated In-Year Receipts	<u>2.12</u>
GROSS PROVISION	<u>4.07</u>

THE PACKAGES: 1985/86 CAPITAL SPENDING

	<u>Chancellor</u>	<u>P Jenkin</u>
	£bn	£bn
Allocations		
Housing	1.576	1.67
Other Services (eg rubbish, fire etc)	0.32	0.32
Education	0.325	0.325
Transport	0.64	0.64
PSS	0.07	0.07
Compliance Allocation*	<u>0.1</u>	<u>0.1</u>
TOTAL	3.031	3.125
Prescribed proportion of In-Year Receipts	0.4	0.6
Prescribed proportion of Accumulated Receipts	1.2	1.8
Non-Prescribed Expenditure	<u>0.2</u>	<u>0.2</u>
TOTAL PERMITTED SPENDING 1985/86	4.831	5.725
GROSS PES PROVISION 1985/86	4.07	4.07
ACTUAL SPENDING 1984/85	5.0	5.0

* The "compliance allocation" is the extra permission to spend that will be given to those councils that have obeyed this year's voluntary moratorium.

RECEIPTS

	<u>TOTAL</u>	Proportions "prescribed" - ie allowed to be spent:	
	£bn	<u>Chancellor</u>	<u>P Jenkin</u>
		% = £bn	% = £bn
<u>IN-YEAR:</u>			
HOUSING	1.6	15% = 0.24	25% = 0.4
OTHER	0.5	30% = 0.15	40% = 0.2
TOTAL	<u>2.1</u>	<u>0.39</u>	<u>0.6</u>

ACCUMULATED:

HOUSING	4.0	15% = 0.6	25% = 1.0
OTHER	2.0	30% = 0.6	40% = 0.8
TOTAL	<u>6.0</u>	<u>1.2</u>	<u>1.8</u>

Ready Reckoner: Each increase of 5% in the prescribed proportion for housing (in-year + accumulated receipts) causes a further £280m of potential overspending.

Each increase of 5% in the prescribed proportion for non-housing (in-year + accumulated receipts) causes a further £120m of potential overspending.



Prime Minister

LOCAL AUTHORITY CAPITAL EXPENDITURE

1. During our PESC discussions this autumn colleagues have agreed planning figures for the various local authority capital programmes. It was not until these discussions had been completed that we were able to assemble the whole picture of what our proposals involved for the totality of local authority capital spending in 1985/86 in England as follows:

(i)	Gross Capital (England)	£4.07 bn
(ii)	Receipts	£2.12 bn
(iii)	Net Capital (Cash Limit)	£1.95 bn
	(= (i) -(ii))	

2. The reduction in spending is very steep:

1983/84	£5.5bn)	
)	Outturn
1984/85	£5.0bn)	
1985/86	£4.07bn)	

We estimate that about £3bn of expenditure that is to say $\frac{3}{4}$ of the total available may already be committed for 1985/86 which leaves a relatively small margin for new commitments.

3. The estimated receipts for 1985/86 have also been put at a high level and could easily fall short if sales of council houses and other assets slow down. Colleagues have recognised this in our earlier PESC discussions when we noted that our receipts assumptions were at the high end of the range and might fall short.

4. Both these factors (the steep reduction in planned gross spend, and the possibility of shortfall in receipts) mean that there is likely to be some overspending in 1985/86. The Chancellor wants to limit the danger by tightening up the capital

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control regime over individual authorities. In particular he wants to reduce severely their freedom to supplement their capital allocations by spending from their reserves of capital receipts accumulated from earlier years and any further receipts that they get in 1985/86.

5. I do not dissent from the general objective. But I believe we are severely constrained by 3 factors.

6. Pressures for Capital Spending

First, there is the groundswell of opinion in the party that we ought to be increasing capital spending not reducing it.

To impose a reduction from £5bn to £4bn in a single year would mean a virtual moratorium for many authorities throughout the year. For some authorities existing commitments may actually exceed the proposed Treasury limits. I am not of course proposing to re-open our PESC decisions on the planning total for local authority capital programmes. But I do not believe the party would accept so draconian a cut back on our capital spending at the present time. We would have to justify such a regime principally to Conservative controlled District Councils who have been particularly vigorous in implementing our RTB policy.

7. Allocations

Secondly we have promised local authorities in the White Paper last year that for Housing and Other Services they would have capital allocations at least 80% of their 1984/85 allocations. To deliver this promise and to take account of the new statutory scheme of assistance under the Housing Defects Act and other changing needs (eg for repair of defective system-built houses) I need a total of £1670m for housing allocations - £94m more than the Chancellor is offering. If we break this promise we may be open to legal challenge. It will also be impossible to give credible assurances for future years about the level of allocations for which authorities can plan, in the way that the Chancellor and I would both wish.



8. Use of Capital Receipts

We have given authorities repeated assurances that they would be able to use a substantial proportion of their capital receipts to supplement their capital allocations, so as to give them an incentive to maximising sales. To reduce the prescribed proportion of receipts which authorities may spend from 40% to 15% for housing and from 50% to 30% for other services would be a devastating blow. It would bear particularly hard on shire districts, and would thus contradict the remit from E(A)(84)26th meeting to devise a system that would "give favourable treatment to those local authorities who had co-operated responsibly with the Government's policy objectives."

9. Likely Reactions

We have had a foretaste of the likely reactions in response to my call for restraint in capital spending this year. 150 MPs, 130 of them our own supporters, have written to me. DOE Ministers and the Paymaster General have found this action, which in effect curtailed the use of accumulated receipts, caused more resentment amongst our supporters than perhaps any other aspect of our local government policies.

10. I recognise that the Chancellor's latest proposals are less severe than initially put by the Chief Secretary to E(A). Nevertheless they still contain elements particularly the reduction of the prescribed proportion to 15% which would lead to an explosion of anger. They would unite against us the groups of authorities most generally disposed to support us; the construction industry which will see these measures as a direct attack on investment in our infrastructure; and those of our backbenchers who are opposed to cutbacks in capital spending. It will reduce the total spending power of shire districts to some 65% of this year's level, and open us to legal challenge and conflict in some of our most loyal areas. In the major conurbations where housing stress is most acute it will be a potent weapon in the hands of extremists. I cannot think of a worse moment, as abolition, the RSG settlement and rate capping come before the House, at which to antagonise our supporters on a new local government issue.



11. Colleagues will remember that last year we reduced the prescribed proportion for housing receipts from 50% to 40%. With great reluctance I have offered a reduction from 40% to 25%; and that is as far as a Government should go.

12. Similar issues apply to receipts from disposals of non-housing assets and housing land. I am willing to move down from 50% and 100% respectively to 40%. But the Chancellor wants to go to 30%. This move would seriously weaken the incentive for authorities to generate such receipts, over which they have complete discretion.

13. I should remind colleagues that reductions in prescribed proportions are subject to negative resolution of both Houses. The necessary Orders will have to be laid early in the New Year.

14. Conclusion

To summarise, my proposals are:

- that allocations should total £3.125bn (£94m more than the Chancellor proposes) with £1.670bn for housing
- that the prescribed proportion for most housing receipts should be reduced from 40% to 25% and for non-housing and housing land receipts from 50% to 40% and
- that we should give a public indication that future allocations for housing and Other Services would be at least 70% of 1984/85 levels in 1986/87 (as offered in last year's White Paper) and 80% of 1985/86 levels in 1987/88 (para 7).

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15. I entirely agree with the Chancellor that we must press on with our longer term review of the system which is clearly unsatisfactory in its present form.

16. I am sending copies of this minute to the other members of the Cabinet, the Paymaster General and the Chief Whip, and to Sir Robert Armstrong.

PJ

PJ

12 December 1984



Ref. A084/3339

PRIME MINISTER

Cabinet: Local Authority Capital Controls System 1985-1986

BACKGROUND

The system of controlling capital expenditure by local authorities in England and Wales has been discussed by Ministers collectively on several occasions. The arrangements for 1985-86 are the most pressing matter: work on arrangements for the longer term is in hand separately.

2. The meeting of the Ministerial Sub-Committee on Economic Affairs which discussed the issues on 20 November (E(A)(84) 26th Meeting) was inconclusive. The Chancellor of the Exchequer was invited to hold a meeting of the Ministers mainly concerned in order to seek to devise a compromise between the proposals of the Secretary of State for the Environment and the Chief Secretary, Treasury. The meeting was to seek, among other things, to give favourable treatment to those local authorities who had co-operated responsibly with the Government's policy objectives.

3. The Chancellor of the Exchequer's informal group has met twice. Although both Treasury and Environment Ministers have shifted from the position they took at the meeting of E(A), they have still not been able to reach final agreement. Both the Chancellor of the Exchequer and the Secretary of State for the Environment consider that the issues are so important that they must be resolved by the Cabinet. Their current proposals are set out in their minutes of 11 and 12 December. The difference of views concerns only England: the Secretary of State for Wales has reached agreement with the Chief Secretary, Treasury on arrangements for Wales (though he has reserved the right to reopen the agreement if what is agreed for England is significantly more generous); and the Scottish system of control is altogether different.



Present arrangements

4. The present arrangements are described in paragraphs 3 to 5 of the Chancellor of the Exchequer's minute. Their main features are as follows.

(a) The relevant cash limit is set in net terms: gross expenditure less receipts during the year from sales of assets. The figures for 1985-86 are: gross expenditure £4.07 billion, less receipts of £2.12 billion, giving a net cast limit of £1.95 billion.

(b) Individual local authorities are given gross allocations, which they may supplement by spending up to a 'prescribed proportion' of capital receipts.

(c) In determining the total of gross allocations, account is taken of the spending power deriving from the 'prescribed proportion' of receipts during the year, but not of the spending power deriving from the 'prescribed proportion' of receipts accumulated in previous years.

It follows that, if local authorities both spend their gross allocations in full and draw on accumulated receipts to a significant extent, they may collectively overspend the cash limit by a wide margin, even though no individual authority is acting outside the rules.

5. The 'prescribed proportion' for housing receipts is 40 per cent; and accumulated housing receipts are believed to be of the order of £4 billion: the proportion for most other receipts is 50 per cent; and accumulated non-housing receipts are believed to be of the order of £2 billion. The purchasing power derived from accumulated receipts is thus very large - some £2½ billion - and, as noted above, the whole of it under present arrangements is a potential overrun on the cash limit.



6. The Chancellor of the Exchequer's main proposal is therefore to reduce the 'prescribed proportions' as follows.

- (a) For housing receipts, from 40 per cent to 15 per cent.
- (b) For housing land, from 100 per cent to 30 per cent.
- (c) For non-housing receipts, from 50 per cent to 30 per cent.

These proportions would apply to both accumulated and in-year receipts: it is not legally possible to distinguish between them (though it is possible, as the Chancellor's proposals envisage, to distinguish between receipts arising from the sale of different types of asset). The Chancellor of the Exchequer also proposes gross allocations totalling £3031 million. The break-down is given in the Annex to his minute: it includes £100 million for supplementary allocations which would be distributed to those local authorities which had 'co-operated responsibly with the Government's policy objectives' by responding to the request for restraint in capital expenditure made earlier this year.

7. Finally, the Chancellor of the Exchequer proposes a more generous system of end-year flexibility on the lines described in paragraph 16 of his minute.

8. The Secretary of State for the Environment argues that these proposals are too severe. He suggests that allocations for housing, and hence the total of gross allocations, should be £94 million higher than proposed by the Chancellor of the Exchequer, and that provision of this size is needed in order to avoid a risk of legal challenge. He also argues that the reductions in the 'prescribed proportions' proposed by the Chancellor are too severe. Instead, he proposes that the 'prescribed proportion' for most housing receipts should be 25 per cent, and for housing land and other receipts 40 per cent. He also proposes that the Government should give a public indication that future allocations for housing and other services would be at least 70 per cent of 1984-85 levels in 1986-87 and 80 per cent of 1985-86 levels in 1987-88.



MAIN ISSUES

9. Some of the remarks in paragraph 6 of the minute from the Secretary of State for the Environment appear, despite the disclaimer, to question the Cabinet's decisions on this year's Public Expenditure Survey. Those decisions imply gross capital expenditure on the programmes in question of just over \$4 billion; and the question before the Cabinet is how the risk of any overspending beyond that figure, not covered by additional receipts, can be contained within acceptable bounds: it would not be right to construct a loose system of control in order to avoid the rigours of the Cabinet's decisions. The specific questions are:

(i) What should be the total of gross allocations? ^{+194m.}

(ii) What should be the 'prescribed proportions' for the various categories of capital receipts?

In addition, it will be necessary to discuss:

(iii) how should the Government's decisions be announced?

Gross allocations

10. I understand that the proposals in the Annex to the Chancellor of the Exchequer's minute are acceptable to the Ministers concerned, except that the Secretary of State for the Environment wishes for housing allocations totalling £1670 million - £94 million more than the Chancellor proposes.

11. The Government is committed to giving local authorities at least 80 per cent of the housing allocations they received in 1984-85, that is, 80 per cent of £1853 million, which is equal to £1482 million. But to provide only this minimum figure would not be acceptable, partly because it would not allow allocations to be influenced by needs (which naturally change from year to year) and partly because it would risk legal challenge as a failure to



exercise reasonably the discretion available to the Secretary of State. The Chancellor proposes £1576 million (85 per cent of the 1984-85 allocation); Mr Jenkin is effectively asking for just over 90 per cent. It is doubtful whether as much as that is required to avoid legal challenge.

12. A point that the Cabinet will wish to explore further is how Mr Jenkin sees the relationship between his proposals and the £100 million supplementary allocations which he also envisages. Presumably a substantial proportion of this sum would go to housing. If the proportion were, say, 50 per cent, then allocations in 1985-86 would be nearly 93 per cent of the 1984-85 total, despite the sharp reduction in provision which the Cabinet agreed in the context of the Public Expenditure Survey.

13. In discussion in the Chancellor of the Exchequer's informal group the Secretary of State for the Environment indicated that he would be willing to absorb at least part of the £100 million supplementary allocations within the £1670 million which he was, and is, seeking for housing. It may be possible to build on this to construct a satisfactory compromise figure. You might suggest £1600 million as a possible compromise between the Chancellor's £1576 million and Mr Jenkin's £1670 million. This would, like their figures, be enhanced by a supplementary allocation of £100 million.

'Prescribed proportion' of capital receipts

14. It is common ground that it is reasonable to have a significantly lower 'prescribed proportion' for housing receipts (other than receipts from housing land) than for other capital receipts because it is not necessary to give local authorities so big an incentive to sell housing: the main drive for sales of housing comes from the tenants' right to buy. In deciding what the 'prescribed proportion' should be, Ministers will need to balance the following considerations.



(a) A low 'prescribed proportion' reduces the incentive to sell assets, and may depress receipts. If that happens, because the cash limit is net of receipts, it presents just as big a threat to the limit as excessive gross expenditure.

(b) A low 'prescribed proportion' reduces the ability of local authorities to spend receipts on a timescale of their own choosing. It may be regarded as inconsistent with past assurances that local authorities would be able to use a substantial proportion of their receipts to supplement capital allocations. Some local authorities will no doubt have entered into commitments for 1985-86 on the assumption that they would be free to use a substantial proportion of their accumulated receipts in that year.

(c) But the higher the 'prescribed proportion', the greater the risk of overspending. A 5 per cent increase in the prescribed proportion of housing receipts increases the spending power of local authorities by about £280 million; the corresponding figure for non-housing receipts is about £125 million. (There is some uncertainty about the precise numbers, because the split of accumulated receipts between housing and non-housing is not known with complete accuracy). In practice, the whole of the spending power available to local authorities is unlikely to be used. For this reason, the Chancellor of the Exchequer believes that his proposals, while in theory allowing an overspend of about £3/4 billion, should not create the risk of a serious overrun. The Secretary of State for the Environment will no doubt argue that although his proposals would in theory allow an overspend of about £1½ billion, the practical risk is a good deal less. He will point out that local authorities in recent years have not spent more than about 70 per cent of the theoretical maximum (though the figure in 1984-85 might have been higher if mid-year corrective action had not been taken). Against that, the factors to which Mr Jenkin himself draws attention in paragraphs 3 and 4 of his minute may tend to increase the proportion.



15. In round terms, the Chancellor of the Exchequer's proposals would allow local authorities to spend a theoretical maximum of about £4.8 billion, and Mr Jenkin's £5.6 billion. In practice the Chancellor considers that under his proposals there would be not risk of significant overspend. Mr Jenkin has not given a figure for likely overspend in practice under his proposals but if local authorities were to spend say 80 per cent of the theoretical maximum the overspend would be about £400 million. To avoid over-spending on Mr Jenkin's proposals local authorities would have to spend less than 75 per cent of the theoretical maximum. Is he prepared to advise the Cabinet that this would be a safe assumption?

16. If the Cabinet consider that the risk of overspend implied by Mr Jenkin's proposals is excessive but are nevertheless impressed by Mr Jenkin's arguments that local authorities' access to receipts should not be curtailed too sharply, they may wish to opt for a compromise solution. One obvious course might be to split the difference between the two sets of proposals as follows.

Prescribed proportions (per cent)

	Chancellor's proposals	Mr Jenkin's proposals	Possible compromise
Housing receipts	15	20	20
Housing land receipts	30	40	35
Non-housing receipts	30	40	35

This might produce a theoretical maximum spend of £5.2 billion compared with £4.8 billion under the Chancellor's proposals and £5.6 billion under Mr Jenkin's proposals. If local authorities were to spend 80 per cent of the theoretical maximum, the overspend in practice over the gross provision would be about £100 million.

Handwritten notes: "80% = 200 mls" and "80%".

Handwritten note: "5.1"



1300-

End-year flexibility

17. The proposals in paragraph 16 of the Chancellor of the Exchequer's minute seem likely to be acceptable to the Cabinet. I understand that the Secretary of State for the Environment does not intend to press a proposal he made in previous discussions, that the Government should give local authorities an assurance that there will be no mid-year corrective action of the sort taken in 1984-85 to avert a threatened overspend.

Announcements

18. Both the Secretary of State for the Environment and Treasury Ministers will be anxious to make announcements as quickly as possible so that local authorities can be given their allocations for 1985-86: delay increases the risk that authorities will enter into binding commitments that cannot be accommodated within the allocations that are eventually made. You will wish to invite the Secretary of State for the Environment to clear the draft of an announcement with the colleagues mainly concerned, and to agree with the Chief Secretary, Treasury the extent of any commitments regarding allocations for 1986-87 and 1987-88.

HANDLING

19. You will wish to invite the Chancellor of the Exchequer to open the discussion and the Secretary of State for the Environment to respond. The Home Secretary and the Secretaries of State for Education and Science, Social Services, and Transport, the Minister of Agriculture, Fisheries and Food and the Chancellor of the Duchy of Lancaster will wish to comment as the other Ministers with significant local authority capital programmes. The Chief Secretary, Treasury will wish to comment on the general implications for the control of public expenditure. The Secretaries of State for Scotland and Wales may wish to comment on any implications for their countries.



CONCLUSIONS

20. You will wish the Cabinet to reach conclusions on the following.

(i) What should be the total of capital allocations for English local authorities in 1985-86?

(ii) What should be the 'prescribed proportion' for capital receipts

- from housing;
- from housing land;
- from other assets?

(iii) Are the Chancellor of the Exchequer's proposals on end-year flexibility accepted?

(iv) How and when should the Government's decisions be announced?

A handwritten signature in blue ink, appearing to be 'R. Armstrong'.

Approved by
ROBERT ARMSTRONG
and signed in his absence.

12 December 1984

010

Prime Minister
Mr King seems to split difference between Chancellor and Mr Jenkin.

AT
12/12



CONFIDENTIAL

Prime Minister

LOCAL AUTHORITY CAPITAL CONTROL SYSTEM

As you know, I have to be in Brussels tomorrow and am therefore writing to you with my comments on the Chancellor's proposals for changes to the local authority capital control system. I have also seen the minute from the Secretary of State for the Environment on this matter.

My own view is that given the scale of the potential overspend there clearly must be some reduction from the previous levels agreed for allowable capital receipts if we are to maintain a reasonable control over public expenditure. However I have serious reservations about whether that reduction should be anything like as great as the Chancellor is now suggesting.

The issue is particularly embarrassing against the background of our previous undertakings about use of receipts which we gave to local authorities to encourage them to sell more council houses. The massive scale of the potential overspend is evidence itself of the success of the sales campaign which produced such substantial receipts. Moreover, the local authorities are not breaching the rules of the capital control scheme, which was specifically designed, with the support of the Treasury, to get away from the previous practice that the receipts had to be spent in the year a scheme was approved which led so often to wasteful and inefficient use of resources.



CONFIDENTIAL

It is therefore clear that we shall be very strongly attacked for breach of previous understandings. I believe, however, that the scale of the expenditure means that there must be some move from the levels proposed by Patrick Jenkin, but I do not believe that it would be right to move as far as the Chancellor has suggested. In taking this view I also have in mind the important point that the political authority for capital expenditure does not necessarily mean there is also the cash available to make the investment.

I note also Patrick Jenkin's warning that reductions in the prescribed proportions are subject to negative resolution in both Houses, and this is clearly going to be a very difficult obstacle. It would be difficult enough to get acceptance even if some compromise position could be reached, and I would judge it to be very difficult indeed to get this acceptance at the levels set out in the Chancellor's paper.

I am copying this to members of Cabinet and Sir Robert Armstrong.

T K

12 December, 1984

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