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K01199

PRIME MINISTER

Local Authority Capital Expenditure

FLAG A — (Letter of 29 July from PS/Chief Secretary
to PS/Prime Minister)

BACKGROUND

1. The Local Government Finance Studies will be putting forward proposals for a new system for controlling local authority capital expenditure in the longer term. However, E(A)(85)12th meeting on 1 July considered two proposals for legislation next session to deal with problems in the interim. One proposal, to plug a loophole concerned with mortgage finance was agreed. The other, to deal with the growing overhang of accumulated capital receipts, the so-called "cascade", was not finally settled. Summing up the discussion you said:-

"more effective long-term arrangements for controlling local authorities' capital expenditure would have to be settled as part of the Government's wider study of local government finance. Local authorities could not, however, be deprived of the benefit of their accumulated unspent capital receipts, given the Government's repeated commitments on this point. Nevertheless, tight constraints would need to remain on the rate at which the overhang of past receipts could be spent, while maintaining the incentive to authorities to continue to realise assets; this seemed to point to different treatment for past and future receipts. The Secretary of State for the Environment should consider further with the Chief Secretary, Treasury and the other Departmental Ministers concerned, how best to achieve these objectives. Decisions on the public expenditure provision for local authority capital expenditure would need to be taken in the context of the Public Expenditure Round, in the light of this further work."



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Discussion between Mr Rees and Mr Jenkin has failed to resolve the issue and you are holding a meeting tomorrow to consider their latest proposals.

2. The problem arises because the present system permits authorities to spend, in any year, a prescribed proportion (at present 30% in general) of their in-year receipts plus the same prescribed proportion of the accumulated receipts unspent in earlier years. The system necessarily means that the total of accumulated receipts grows year by year (it is £5.7bn this year) so that spending can only be kept within its limits either by cutting allocations (unpopular and politically difficult) or by reducing the prescribed proportion year on year (which also reduces the incentive to authorities to generate receipts).

3. The proposals in front of the meeting are:-

Mr Jenkin's proposals

- (a) No change in the present rules for accumulated receipts from past years up to and including 1985/86. No change in prescribed proportions.
- (b) For future receipts, authorities will not be able to spend the non-prescribed proportion at any time. The prescribed proportion would be fixed statutorily at 50% for most receipts.
- (c) A major uplift in local authority capital provision for 1986/87 onwards. (NB. This issue is for the public expenditure round).

Mr Rees' proposals

- (a) The present rules for accumulated receipts remain for past years up to and including 1984/85 ie not 1985/86.
- (b) No change in prescribed proportions this year.



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(c) The "cascade" is ended for receipts carried forward from 1985/86 as well as from future years.

(d) The prescribed proportion for housing receipts to be increased from 20% to 30% in 1986/87 onwards.

The effects of these proposals on provision etc. are set out in the Annex.

MAIN ISSUES

4. Public expenditure issues should be settled in the Survey discussions (as agreed at E(A)). Permanent longer-term arrangements for controlling local authority capital expenditure will come to E(LF) in due course. This meeting should focus on the interim issues, viz:-

(i) should the cascade be ended?

If so - should it be ended?

(ii) should it be ended with effect from 1985/86 or 1986/87? and

(iii) what adjustments should be made to the prescribed proportion for in-year receipts?

If not -

(iv) What alternative action should be taken?

Ending the cascade

5. The justification for ending the cascade is that present arrangements "double-count" the non-prescribed proportion of receipts for, at least in principle, they are (a) redistributed to other authorities and available to be spent by them in the year in which they arise and (b) available to be spent by the authority whose receipts they are in subsequent years. In fact while the non-prescribed proportion of receipts was fully redistributed up to 1984/85, only £1bn of the approx. £1½bn available was redistributed ~~up to~~ⁱⁿ 1985/86, and in future years the quantum which can be redistributed will be very small unless there is a major



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uplift in local authority capital provision. Furthermore, because of the overhang of accumulated receipts from the past, elimination of the cascade will not enable extensive redistribution to be restored.

6. Additionally, it is very likely that a proposal to end the cascade will be vigorously opposed. Authorities will argue that it is wrong in principle to remove from them (for ever) the right to spend their own receipts. Whether or not their receipts have notionally been redistributed to other authorities does not affect this point.

1985/86 or 1986/87?

7. If the cascade is to be ended, should it be with effect from the present year 1985/86 (as Mr Rees argues) or from 1986/87 (as Mr Jenkin argues). Mr Jenkin asserts that he gave assurances in the House earlier in the year about authorities' freedom to spend their receipts over time which were taken to include the present year. He therefore regards action on 1985/86 receipts as ruled out by these assurances and asserts that in any case legislation to cover this year could not be secured. The Chief Secretary argues that, because 1985/86 is not yet far advanced, an early announcement would enable authorities to take whatever action they thought best, and would not be open to charges of sharp practice.

The Prescribed Proportion

8. Mr Jenkin suggests that the prescribed proportion should be set at 50% (for most cases) in the legislation. He obviously believes that this will make it easier to secure legislation ending the cascade. Mr Rees concedes only that the proportion for housing receipts should be brought from its present low level of 20% to the general level of 30%.

9. Setting a statutory prescribed proportion at a relatively high level like 50% might help secure legislation. It would,



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however, give Ministers no room for manoeuvre in the future to adjust the proportion for the varying circumstances of each year.

10. If the proportion is not to be set statutorily, I suggest that it should not be set at this meeting either. It is one of the variables available for adjustment each year along with allocations and gross provision to produce an acceptable package. It should therefore be settled in the public expenditure discussions.

Alternative Approaches

11. If complete elimination of the cascade for future years is not acceptable are there other avenues that can be explored? Presumably the objective is to enable service ministers to point to defensible capital allocations for their particular services, and to maintain the incentive on authorities to generate receipts within a reasonable gross provision. As long as the same prescribed proportion has to be applied to both in-year and accumulated receipts (which is what the present legislation requires), the overhang of accumulated receipts must have the effect of forcing a reduction in the prescribed proportion or in allocations or both each year unless there is an offsetting increase in the gross provision. Reducing the prescribed proportion will reduce the incentive to generate receipts. One way out may lie, however, in legislating to enable different prescribed proportions to be set for in-year receipts and for accumulated receipts. In this way a relatively high proportion may be set for in-year receipts to maintain incentives, and a relatively low proportion for accumulated receipts to provide head-room for allocations to be maintained or increased. Such an approach would very likely generate its own problems in the longer-term but it might suffice for a few years while new permanent arrangements are devised and put into place. It could be combined with a decision to end redistribution.

HANDLING

12. You may like to make it clear at the outset that this is not the occasion to discuss either public expenditure or long-term



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arrangements. The issue is whether there are acceptable short-term measures which will assist over the next two or three years.

13. You should then ask the Secretary of State for the Environment and the Chief Secretary to introduce their respective proposals. I suggest that you then guide the discussion to consider, first, whether the cascade can be abolished. If so, from which year? If not, are there alternatives? In particular, would a power to set different prescribed proportions for in-year and accumulated receipts be helpful.

CONCLUSIONS

14. You will wish to register conclusions on:-

- (a) whether the cascade, ie authorities' entitlement to spend their accumulated receipts, should be ended;
- (b) If so whether this should be with effect from 1985/86 or 1986/87, and whether the prescribed proportion should be set at a statutory level (50% or 30%) at the same time;
- (c) If not, whether the setting of different prescribed proportions for in-year and accumulated receipts should be legislated for, and whether with or without an end to redistribution.
- (d) Whether any other alternatives should be pursued as interim solutions for legislation early next session.

C J S BREARLEY

30 July 1985

ANNEX

£bn	1985-86		1986-87	
	1	2 Status Quo	3 DOE PROPOSAL End cascade from 1986/7. Increase average pp from 25% to 50% for receipts in 1986/87 and beyond.	4 TREASURY PROPOSAL No cascade from 1985/86. Increase average pp from 25% to 30% for receipts in 1986/87 and beyond (and any unspent receipts from 1985/86).
Total accumulated receipts	5.7	6.3	6.3	4.7
Total spending power from receipts	1.7	2.1	2.6	1.8
Allocations (assuming 85% use of spending power and baseline provision)	3.0	2.3	1.8 [†]	2.6
Gross provision	4.03*	4.1	4.1	4.1

* Forecast outturn in range 4.0-4.9

[†] It is accepted that this figure for allocations is unrealistically low. Any higher figure, combined with the other elements in column 3, would imply spending above baseline provision.