PRIME MINISTER 5 September 1985

LOCAL AUTHORITY CAPITAL SPENDING 1986/7

The official analysis shows that our proposed method of ending the build-up of 'accumulated receipts' is technically feasible and could probably be introduced without primary legislation. But spending Departments are extremely unhappy about the effect on borrowing allocations.

There is no way of squaring this circle.

The present system allows authorities to spend only 25% of their receipts in the year in which they are received. The remaining 75% of the money received counts as negative public spending, and borrowing allocations can be increased pro rata, without overshooting the PESC baseline. The problem is that the 75% crops up again in the form of 'accumulated receipts' (ie accumulated spending permissions) in later years.

Our proposal would allow authorities to spend the full 100% of their receipts in the year in which they are received. As a result, there would be no accumulation of spending permissions in later years. But in contrast to the present system, the bonus of negative public spending equal to 75% of in-year receipts would disappear; borrowing allocations could not, therefore, be increased without overshooting the PESC baseline.

From the point of view of local authorities as a whole, the effects of the two systems in 1986/7 would be nearly identical: they would be able to spend roughly the same amount either way. But a change to our system would produce big gains and losses for individual authorities.

a. those with large in-year receipts would gain;

b. those with small in-year receipts would lose.

The spending departments argue that:

i. Some of the Government's supporters in the shires and districts would be furious because they have already sold off everything in sight and consequently now have small in-year receipts.

ii. This is too late in the financial year to introduce such gains and losses.

iii. Spending Ministers should be able to control local capital spending by fine-tuning borrowing allocations: any system which leaves so much to local initiative is objectionable.

Argument iii. can be dismissed. Central control of local capital spending has never worked: it would be better to let local authorties earn more of their spending by selling off surplus property.

But arguements i. and ii. have some force. Many of the Government's supporters do feel that they have already sold off enough property; and it is late in the year for such a big change in the system.

Given these problems, the Treasury do not seem willing to push for the proposed changes. And they have given up on their own legislative proposals, because the Whips have convinced them there would be a massive rebellion in both Houses.

<u>We reluctantly conclude</u> that it will not be possible to get either our system or any other equivalent changes into

operation for 1986/7. The result of this failure will be another big addition to 'accumulated receipts' - probably in the region of £500 million - £700 million.

Such a disappointing outcome will be tolerable only if the Government moves rapidly towards more honest accounting practices. This means:

i. getting a proper new system in place for 1987/8, regardless of the progress of the other local finance reforms;

ii. ensuring that, in 1986/7, the net provision announced in the Public Expenditure White Paper is not overspent.

Last year, the Government fudged its estimates of local spending to produce larger allocations than were compatible with the net provision; as a result, a £600 million overspend is predicted for 1985/6. To avoid a repetition in 1986/7, Departments will have to be told that allocations must this time be based on realistic estimates of local spending. True, this will increase the pressure for higher net provision, but it will ensure that the figure agreed in the Survey is actually delivered.

<u>We recommend</u> that you should reply to Ken Baker, making these points explicitly and strongly. A draft reply is attached.

I have changed this somewhat. The draft is attached to my minute.

OL

OLIVER LETWIN