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My ref:

Your ref:

16 July 1985

Dear Chief Secretary

LOCAL AUTHORITY CAPITAL EXPENDITURE 1986/7 - TREATMENT OF CAPITAL RECEIPTS

Following the E(A) discussion on 1 July, our officials have been considering proposals for legislation in respect of capital receipts. You and I are to meet on Thursday this week, 18 July, for a preliminary discussion. I thought it would be helpful to set out in advance, for you and other interested colleagues, my proposals on the way in which we should implement the E(A) decision. I am writing separately about mortgages.

The Prime Minister in her summing up made it clear that there could be no question of depriving local authorities of the right to spend over time the full amount of those receipts which they have already generated. As it is not practicable to make mid-year changes in the rules, I take this to mean that the cascade effect must continue to apply to receipts arising up to 31 March 1986. There was also sympathy at the meeting for the view that, in the light of the difficulty in getting through the changes for 1985/6, it was not practicable to contemplate any further reduction in the prescribed proportions for accumulated receipts. This points clearly towards leaving the situation in respect of accumulated receipts exactly as it is now and legislation only in respect of receipts arising next year and thereafter. We should aim to restore the original intention behind the 1980 Act that the relevant prescribed proportion should be applied to any given receipt on a once-for-all basis. Even that step will be difficult to get through the House and we shall need to offer an increase in the prescribed proportion for future receipts as a recompense.

I therefore propose the following as the maximum package which would in my view command assent in Parliament:

- a. The present rules should continue to apply to all receipts generated on or before 31 March 1986, ie up to and including the present financial year. The cascade rule would continue to operate, and the prescribed proportions would be unchanged at 20% for most housing receipts, 30% for housing land and most non-housing receipts, 100% for low cost home ownership receipts and 1% for repayment of Housing Association Grant.

b. New rules would apply to all receipts generated on or after 1 April 1986. The cascade rule would be ended. Authorities would be able to spend in any one or more years the prescribed proportion applying when the receipt is generated, but no more at any time. To give authorities greater certainty, the prescribed proportion would be fixed. It would generally be 50%, except that the present 100% and 1% proportions would not be changed. There are other small adjustments for which I would wish to argue, including restoring housing land receipts to 100%.

This proposal should minimise the political opposition to legislation. It has positive presentational features: the choice of 1 April 1986 avoids any suspicion of retrospection; the raising of the prescribed proportion thereafter would help to offset the adverse effect for authorities of ending the cascade; and the fixing of the prescribed proportion would remove the most annoying uncertainty in the present system so far as authorities are concerned.

It will be important if we are to sell this change successfully that it should not come as a bolt from the blue. We do not want accusations of bad faith. I would like therefore to say something about it at next week's meeting of the Consultative Council on Local Government Finance. I may in any case be pressed to say something about the timetable for legislation on the longer term review. I would propose to say that I have ruled out major legislation in the 1985/6 session. But I would then go on to say that we are considering two minor changes, one of which would be the end of the cascade. I need at the same time to be able to give an absolute assurance that we shall not be depriving authorities of the right to spend over time the whole of receipts accumulated up to and including this financial year; otherwise we shall start hares and there will be a rush to spend before the legislation takes effect.

The above proposal is, as I say, as far as I believe we can go. I am well aware that the above proposal does not offer an immediate reduction in excess spending power in 1986/7. However, I have to put it to you that I do not believe that the House of Commons would agree to any more stringent measures. If that is right, then our next problem will be to reconcile the outcome with the cash limit for local authority capital implied by the present baseline. I attach a table which shows what would have to happen to capital allocations if the existing baseline is to be delivered. I am sure you will see that the level to which allocations would have to be reduced is, quite simply, unrealistic, (and for 1987/8 it would get even worse). We therefore face a choice. Either we could repeat last year's exercise which involves making harsh cuts only to find that local authorities fail to deliver so that we get the worst of all worlds; or we could recognise reality, make an estimate of what we think local authorities will actually spend and increase the PESC provision accordingly. When we come to the bilaterals, the bids which I and other spending Ministers have made will therefore have to be treated very seriously. The bald fact is that present plans are not deliverable because there is no combination of rule changes and allocation levels designed to meet them which we can sell to Parliament, to say nothing of the continuing deterioration of local infrastructure implicit in them.

I am copying this letter to the Prime Minister, Keith Joseph, Nick Edwards, Nicholas Ridley and Norman Fowler, and to Sir Robert Armstrong.

Yours sincerely

for Atkin

PATRICK JENKIN

Approved by the Secretary of
State and signed in his absence

EFFECT ON 1986/7 ALLOCATIONS AND ACCUMULATED RECEIPTS OF ENDING CASCADE

£m

| 1986/7 provision | PRESENT SYSTEM WITH CASCADE | | ENDING THE CASCADE PRES. PROP. 50% FOR NEW RECEIPTS ¹ | |
|--|--------------------------------|-------------|--|-------------|
| | 4150 (baseline) | 5000 | 4150 (baseline) | 5000 |
| 1. Total spending power (provision ÷ 0.85) | 4875 | 5875 | 4875 | 5875 |
| 2. Spending power from accumulated receipts (6300 x 0.25) | 1575 | 1575 | 1575 | 1575 |
| 3. Spending power from in year receipts (assumed to be 2000) | 500 | 500 | 1000 | 1000 |
| 4. New prescribed expenditure | 450 | 450 | 450 | 450 |
| 5. Allocations (now 1 less rows 2 to 4) | <u>2350</u> | <u>3350</u> | <u>1850</u> | <u>2850</u> |

¹ For further details see covering letter

