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LOCAL AUTHORITY CAPITAL EXPENDITURE CONTROL

Chapter 6 of the Green Paper "Paying for Local Government" deals with the review of the local authority capital expenditure control system and promises a separate, more detailed, consultation paper about our proposals for a new system.

A draft of this document, which has been seen by officials in Treasury, DES, DHSS, DTP and Welsh Office, is enclosed together with a synopsis of the contents - the synopsis will not be published. The paper has two purposes:

a. It amplifies the main features of the gross expenditure control proposal set out in the Green Paper and explains the intrinsic differences from the present net system.

b. It discusses various details of the present system which have caused difficulty and which it might be desirable to change whatever the new form of expenditure control being adopted.

i. Some, such as the proposal to allow a limited addition to spending from revenue contributions, would give authorities some extra flexibility to set against the increased tightness of the basic system.

ii. Others, such as the proposals on direct labour organisations and on the setting up of a large projects pool, are matters on which we can afford to be agnostic and await reactions: they are intended to respond to criticisms from authorities of the present system, but there is a downside to each proposal for local government too.

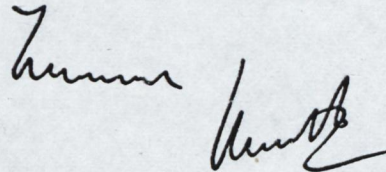
iii. Most important at the moment is the remaining group of considerations, for example on leasing and deferred purchase, where we may be wanting to tighten up on the present controls. The objective in drafting these sections has been to leave local government in no doubt of that possibility, so that there can be no suggestion afterwards that they were not given due warning.

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We shall of course need to look again at all these details when the comments are in.

Subject to any comments which colleagues may have on the text, my aim is to publish the paper on 12 February to give consultees sufficient opportunity to comment on our proposals by 14 April, the date by which comments on Chapter 6 are also invited. I would therefore be grateful for any comments on the draft by 5 February.

I am copying this letter and enclosures to the Prime Minister, members of E(LF) and Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to read 'Kenneth Baker', written in a cursive style.

KENNETH BAKER

Rt Hon John MacGregor OBE MP

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(Draft of 27 January 1986)

LOCAL AUTHORITY CAPITAL EXPENDITURE CONTROL IN ENGLAND AND WALES

CONSULTATION PAPER ON GROSS EXPENDITURE CONTROL BY THE DEPARTMENT OF THE ENVIRONMENT

Introduction

1. Chapter 6 of the Green Paper "Paying for Local Government" (Cmnd 9714) describes broad options for a replacement to the present system of capital expenditure control in England and Wales. This consultation paper should be read in conjunction with the Green Paper. It discusses some of the points covered by the Green Paper in more detail, and also deals with other important issues which need to be settled before a new system is introduced.

2. The Green Paper's review of capital expenditure control may be summarised as follows:

The economic arguments set out in Chapter 1 for constraining revenue expenditure apply equally to capital. Moreover, a large proportion of capital investment is financed from borrowing and hence affects the local authority borrowing requirement, which is of direct relevance to the economy. A control system is bound to focus on either capital expenditure or borrowing, but must strongly influence both. It must also encourage asset sales, sensible capital expenditure planning and value for money at the local level. (6.1 to 6.7).

Neither the system of borrowing control which operated prior to 1981, nor the system of expenditure control introduced that year, has achieved these objectives. Various factors, notably the successful promotion of asset sales and permissive interpretations placed on the controlling legislation, have led to a build-up of spending power under the present system which has made it difficult to hold spending down to planned levels. Rule changes designed to cope with that problem have reduced the incentive to sell assets and undermined the stability of the system. (6.8 to 6.12)

The local authority associations have argued that direct control on the capital side is unnecessary, given constraints on revenue. The Government cannot accept this. Neither can it accept that an improved version of the pre-1981 borrowing control system would achieve the results it is seeking. More radical forms of borrowing control have therefore been considered. The one which comes closest to being practicable and having the potential to satisfy the objectives is a control over all external borrowing by a local authority for both capital and revenue purposes. But it is not clear how an individual external borrowing limit could be devised for each authority, nor what arrangements could be made to provide a "safety valve" for local authorities with an unforeseen difficulty in living within such a limit. (6.13 to 6.25)

Provisionally, the Government prefers instead a new form of capital expenditure control. The national cash limit could be set on gross provision, so that it would be unaffected by fluctuations in the level of receipts in a year. Allocations would continue to be based at least in part on need as at present. The spending power derived from capital receipts would either be incorporated in allocations or remain available as a separate supplement. Authorities would be free as now to vire spending power between services. Transitional arrangements would ensure that local authorities had the opportunity to use existing capital receipts from which the money remains unspent. They might also be able to add to spending to a limited extent from budgetted revenue contributions. A simple form of borrowing control would continue to operate alongside the expenditure control. The Government believes that these arrangements would amount to a stable system which would work well at both national and local level. (6.26 to 6.43)

3. At this stage, the Government does not rule out the option of a control over the external borrowing of each authority, expressed through an individual external borrowing limit, since, if operated successfully, it could guarantee that a desired level of LABR would not be exceeded. But if the Government should decide in the light of consultation to opt for such a system, it would not be

practicable to introduce early legislation. There would first need to be further discussion of the details of such a system. By contrast, a gross expenditure control system could be introduced at an earlier date. Accordingly, this paper is concerned solely with the details of a possible gross capital control system, so that they may be fully considered in advance of possible legislation and implementation.

Cash limit

4. At present the national cash limit for each year is determined as the difference between the aggregate level of spending by authorities planned by Government for a financial year and the aggregate of capital receipts which it is forecast that authorities will generate in that year. Fluctuations above or below the forecast level of receipts have contributed to under or overspending of the national cash limit. Under a gross capital expenditure control system, in-year receipts would no longer directly affect the national cash limit, which would be set simply as the aggregate level of gross capital expenditure by local authorities for the appropriate blocks of services.

5. The Government would expect to continue the present arrangement for end-year flexibility on the national cash limit. The present rule is that if the limit is underspent in any one year, the provision for the following year is increased to match the underspend, up to a maximum percentage (at present 5%) of the cash limit for the year in which the underspend occurs. This is explained in more detail in DOE Circulars 6/84 and 9/85 and Welsh Office Circulars 20/84 and 17/85.

Allocations and Capital Receipts

6. The money generated from selling assets would as now remain with the local authority and could be applied for any purpose appropriate to capital monies, including the redemption of external debt. But the Government also wants to maintain an incentive for authorities to sell assets by enabling them to undertake additional capital expenditure with the proceeds. This might be done by giving each authority an annual gross capital expenditure allocation, made up in

the same way as under the present system. Rather than permitting authorities to spend a proportion of receipts on top of allocations, the allocation would itself consist of:

- a. a needs element reflecting the authority's need for basic capital investment on the services concerned, and
- b. a receipts element reflecting the authority's performance in generating capital receipts on the service.

7. As an alternative to gross allocations, authorities could be given needs-based allocations, and be able to supplement them by spending a proportion of their accumulated capital receipts. This could happen even within a gross system at national level.

8. At present, the level of capital receipts generated by individual authorities cannot be taken into account by Government when making allocations. This has restricted the Government's scope for allocating resources to those authorities with the greatest spending need. So there would be advantage whichever of the approaches outlined in paragraphs 6 and 7 were adopted in being able to take account of an authority's level of receipts in making the needs element of an allocation under a gross system. But before taking such a power, the Government would wish to consider how far it might act as a disincentive to authorities to generate new capital receipts.

9. To achieve greater stability, the Government would calculate the receipts element of an authority's gross allocation (if the option in paragraph 6 were adopted) or the spending power available from receipts as an addition to the allocation (if the option in paragraph 7 were adopted) as a proportion of the receipts generated by that authority over say the three preceding years. So allocations for year 4 of a new system would be based on the capital receipts generated in years 1-3. The basic allocation would as now be made before the start of the year to which it relates, and therefore before the outturn figure for capital receipts from the preceding year was known. If allocations incorporated an element for accumulated receipts, they would need to be adjusted to take account of that outturn figure when known. This would be done by increasing

or decreasing the level of allocations which would otherwise have been given for the next following year, not by mid-year changes in allocations already notified. The alternative would be to leave a year's gap, with capital receipts generated in years 1-3 being used as a basis for allocations in year 5. This would give greater certainty, but at the cost of deferring use of the receipt by a further year.

10. Although receipts would not immediately constitute additional spending power, authorities would know that they would represent spending power in the future, and so would still have an incentive to make such sales. The Government would as now be able to vary the proportion of spending power derived from receipts. On the information now available, the Government envisages that the spending power from a particular type of receipt over whatever averaging period was chosen would be at least as great as the power derived over the same period in the present system under the prescribed proportions of capital receipts set out in DOE Circular 9/85 and Welsh Office Circular 17/85. Unless the proportion were set at 100% in a particular case, the remainder of the receipt would be taken into account at national level in determining the total for the needs-based element of allocations. It would not be available at any time to the authority which generated the receipt to justify additional capital spending, although the cash would of course be available to that authority to repay debt or to finance expenditure within allocations. In other words, there would be no continuation of the unintended effect under the present system, commonly known as the "cascade", whereby the non-prescribed part of a receipt is both taken into account at national level and also eventually available to enhance spending by the generating authority. Ending the cascade would remove one of the major problems of control.

11. The foregoing relates to receipts generated after the new system comes into operation. The Government does, however, envisage that authorities would be able to use in full for capital expenditure that part of those receipts accumulated under the present system which is still backed by cash. The use of these accumulated receipts could be spread over a transitional period covering say the first three years of the new system, depending on the precise rule selected in paragraph 9 above. The phasing could be skewed towards the earlier years of the transition, to allow for

the fact that by the later years there will be spending power from new receipts building up which will need to be taken into account under the averaging arrangements. This would help authorities to achieve a smooth transition to the new system.

12. As now, the needs element of the allocation would be decided by central Government, in consultation with the local authority associations and individual authorities as appropriate. The need for authorities to be able to plan ahead with confidence about the size of their allocation is recognised. To assist in this, the Government would continue its practice of offering local authorities in England and Wales guidance about the minimum level of allocation which they could expect in future years in respect of a number of expenditure blocks and of taking account of existing commitments in determining the allocations for the others.

Controls

13. Under the existing system, it is not ultra vires for a local authority to exceed its spending ceiling unless a direction has been issued under section 78 of the 1980 Act, but any overspending is automatically deducted from the allocation for the following year. The Government believes that adequate deterrents against spending in excess of permitted resources must form part of any control arrangements. The nature of the mechanism for deterring potential overspenders by authorities under a gross system would inevitably depend on the final form adopted for the system.

Borrowing consents

14. Under the present system, local authorities receive block borrowing approvals which, subject to certain adjustments, are equal to their capital expenditure allocations. If under a new system the allocations were made gross of capital receipts as described in paragraph 6, the borrowing approvals should certainly not exceed the needs element of allocations. Arguably, the borrowing approval should be set at a lower level than that, to reflect at least to an extent the fact that authorities will have an element of cash from receipts available to finance expenditure covered by the needs element of allocations, although under present rules such cash can also be used for investment or debt redemption. Sufficient cash

from receipts would in any event remain available to authorities to finance the element of spending power justified by capital receipts.

Flexibility

15. The Government would continue the present 'tolerance' arrangements which at local level allow each authority to exceed its allocation by a margin (at present 10%), either by using up an underspend from the previous year or by anticipating from the following year, or an element of both. If allocations were made on a gross basis as described in paragraph 6 above the present degree of tolerance on needs-based allocations would be provided by a lower percentage of the allocation figures. But account would have to be taken of the fact that this would also provide the only tolerance on receipts if the proposals in paragraph 6 were followed. The Government also proposes to clarify the law to avoid the present position whereby, in certain circumstances, authorities are permitted to use the tolerance without affecting the following year's allocation, even where there has been no underspending of allocations in previous years.

16. The Government would also maintain the present freedom of local authorities to vire spending resources between services and to transfer allocations from one authority to another. This would need to be subject to a power to earmark resources in certain circumstances for projects which are either particularly significant in themselves or of collective importance. Such resources could not then be transferred to use for another purpose.

Revenue contributions to capital expenditure

17. Under the present system, authorities may choose how to finance capital expenditure, whether from borrowing (up to the limit of their borrowing consent), cash from capital receipts or revenue contributions. But authorities may not add to their spending power by revenue contributions. They have argued that they should be given greater flexibility in this respect, particularly because capital expenditure financed from revenue may in some cases lead to significant revenue savings. Moreover, the ability to add to capital spending at the margin would operate as a further incentive to the effective and efficient management of revenue resources.

18. The Government considers that to give local authorities complete freedom to add to their capital expenditure from revenue would reduce unacceptably the degree of control it seeks over the total of capital expenditure. But it accepts that a degree of extra flexibility is desirable for authorities and believes that limited scope to supplement their spending power by revenue contributions to capital outlay (including special funds) can be accommodated within an effective control system, provided that other problems with the present system - including the cascade (paragraph 10) and free tolerance (paragraph 15) are removed. The supplementation would be subject to a limit which might, for example, be set as a percentage of the basic "needs-based" capital allocations to that authority.

19. Each authority would be required to specify in its annual budget the extent to which it intended to supplement its spending in this way within the permitted limit. That budget figure would then become the maximum amount by which the authority could so supplement its spending power in the year. It would also become in financing terms the minimum revenue contribution to be applied to capital in the year. So if outturn capital expenditure fell short of the sum of allocations plus budgetted supplement, allocations would have to be underspent and borrowing approval foregone.

Non-prescribed capital expenditure

20. Schedule 12 to the Local Government, Planning and Land Act 1980 defines prescribed expenditure by reference to a list of purposes. But certain types of expenditure are, by virtue of regulations, treated as "non-prescribed". They include, for example, short leasehold acquisitions, minor highway improvements, expenditure met by insurance payments, housing repair work financed by cash from capital receipts and "de minimis" items. Although such non-prescribed expenditure does not count towards an individual authority's spending "ceiling", it does count towards the national capital expenditure cash limit. Non-prescribed expenditure has been steadily increasing in recent years. The Government has needed to offset an estimate of non-prescribed expenditure against the amount otherwise available for allocations, in order to hold expenditure close to the national cash limit. The use of non-prescribed expenditure has therefore reduced the national allocation total.

21. If authorities were permitted, as now proposed if an effective gross expenditure control is introduced, to supplement their spending power from revenue, this would provide the opportunity to reconsider the rules relating to non-prescribed expenditure. Where expenditure which is at present non-prescribed is both predictable and likely to be financed from revenue anyway, it would make sense to remove the exemption and let such spending be covered by revenue contributions within the permitted total supplementation of spending power from that source. But there may be a few cases where there are good grounds for retaining an exemption, for example to enable authorities to use insurance payments to the full at any time to replace the capital assets to which they relate. Comments on the necessary scope of such exemptions would be welcome. See also the paragraphs on leasing and trading undertakings below.

Capital receipts by virtue of regulations

22. Similar considerations apply to certain types of payment to local authorities which, but for regulations, would not be regarded as capital receipts. The specific prescribed expenditure for which authorities mostly receive those receipts could reasonably be covered, in resource terms, by the revenue contribution flexibility. However, the Government recognises that, as with the preceding section on non-prescribed expenditure, there may be grounds for providing exemptions in certain circumstances, for example to enable authorities to use in full contributions from nationalised industries, health authorities and certain other centrally funded bodies which are currently treated as capital receipts by virtue of regulations. The Government also considers it important to maintain the incentive for local authorities to undertake low cost home ownership initiatives.

Leasing

23. Finance leases: Under the present system, the leasing of vehicles, plant and equipment under finance leases does not score against authorities' capital expenditure allocations provided that the contract does not entitle the authority to immediate or future ownership of the property. But the capital value of the assets does score against the national cash limit. This was intended to ensure

that authorities should not be hindered from entering into leasing agreements where there are good operational or financial reasons for doing so, but also that the value of such items would be taken into account at national level in public expenditure plans.

24. An increasing amount of local authority capital expenditure is being financed by leasing and this exemption from prescribed expenditure has been one cause of significant instability in the present system. The Government proposes that leases be treated as prescribed expenditure. An exception would be needed for operating leases which are current spending. The definitions of financing leases and operating leases used in SSAP 21 (Accounting for Leases and Hire Purchase Contracts) might be used to distinguish the two types of lease.

25. Property leases: Property leases were brought within the scope of the capital control system in order to ensure that authorities count against the resources available to them the full capital value of property at the time of acquisition, to avoid creating an artificial incentive in favour of leasehold as against freehold acquisitions. Correspondingly, a capital receipt is considered to be generated on the disposal of such a leasehold. The Government considers that this general principle still holds, but proposes if a gross expenditure system is introduced to clarify the rules governing non-freehold transactions and remove some anomalies which have become apparent since 1981.

Profits of trading undertakings

26. Under the present system of controls, local authorities may apply for retrospective allocations in respect of profits generated by trading undertakings. This is a cumbersome procedure, requiring the authority to calculate its profits for the year on a current cost accounting basis, to apply to the Department of the Environment or the Welsh Office in the following financial year for an additional allocation, and then to receive such an allocation back-dated to the year in which the profits were generated. This would be avoided if in future such profits did not add separately to spending power but were taken into account by authorities in the level of revenue contributions provided for in their annual budgets.

27. If the present arrangements were broadly retained, one change might be made to meet a criticism which authorities have made of the present system. Instead of the additional allocations being available for use in the year in which the profits were generated, it could be added to the following year's allocation. This would reduce authorities' forecasting difficulties.

Local authority companies

28. It is open to authorities to establish wholly or partly owned limited companies. Under the present system, capital expenditure by such a company does not count as prescribed expenditure by the authority which controls it, but contributions of a capital nature to the company by the authority do count. So an authority can set up a company in one year and make contributions using the spending power available to it in that year for work to be carried out by the company on behalf of the authority in subsequent years. The effect on an authority capital programme is much the same as with advance purchase schemes, described below. Moreover, such companies have freedom subject to their articles of association to borrow from the financial market without any offsetting reduction in the block borrowing approval of their controlling authority, even where that authority guarantees the borrowing by such companies.

29. The Government believes that local authorities should be encouraged to set up limited companies where a corporate structure and Companies Act procedures are appropriate to the function being performed. This applies, for example, to functions of a commercial nature, such as those to be carried out by the public transport companies being established under the Transport Act 1985 and those which the Government proposes should be established in respect of airports under the Airports Bill currently before Parliament. It may also apply where there is to be a partnership between the public and private sectors. At the same time it is important that authorities should not have an incentive to set up companies in other circumstances simply as a means of circumventing public expenditure controls. The present exclusion of expenditure by companies from capital controls does not sit well with the way in which it is treated under public expenditure definitions. Companies owned or controlled by local authorities affect public expenditure

in two ways. For non-trading companies capital spending undertaken by the company counts as public expenditure. For trading companies it is the total external finance that counts. The new control system will need to reflect this.

Advance and deferred purchase schemes

30. Schemes have been devised which enable an authority to anticipate or defer prescribed expenditure on works carried out in a particular year. In some cases, the person carrying out the works may agree to accept advance or deferred payments himself. More commonly, he is paid on a conventional schedule by a third party such as a finance house, which receives the advance or deferred payments from the authority. In such cases, the Government has been advised that the incidence of prescribed expenditure is only advanced or deferred if:

the agreement relates to a specific works project or projects, rather than to unspecified capital programmes; and

the third party itself has a contractual interest in the project.

But even where such schemes are so structured, they are nevertheless financial devices designed to change the effect of public expenditure controls. Effectively, the intermediate finance house is acting as borrower from or lender to the authority, even though the expenditure incurred, including interest in the case of a deferred purchase scheme, scores against the authority's spending power in the year in which the payments are made to the finance house.

31. The Government is concerned about such devices. It can see no grounds for allowing advance purchase schemes to continue under a new control system. As to the case for deferred purchase, the Government believes that payment should normally be made in the year in which the works to which it relates are carried out, wherever practicable. On the other hand, it must continue to be possible for local authorities to pay for works later than the year in which they are carried out where this occurs in the normal course of business,

including cases where contracts provide for retention or a final settlement is disputed in the Courts. This means that it is not practicable to prevent deferred purchase entirely, but it would be possible to curtail the period for which the incidence of prescribed expenditure may be deferred.

Other issues

32. A number of other issues have arisen in the operation of the present system which might be looked at in moving to a new expenditure control system.

33. Large schemes: Under the present system in England, some authorities, particularly smaller ones, have experienced difficulty in generating the spending power necessary to undertake one-off schemes requiring what is for them high expenditure over a short period of time. This problem arises particularly on services covered by the Other Services block. Such authorities should be helped by the proposals on tolerance between years, virement of resources between services and limited additional spending financed by revenue contributions, as outlined above. The Government also envisages that, as now, authorities should be free to transfer allocations to each other, thus enabling a group of authorities to provide joint facilities to assist each other, perhaps over a number of years, in finding the resources for a large scheme.

34. The Government invites comments on the possibility that in England, in addition, it might hold back some of the resources available for allocation as a "large projects pool" to which, after consultation with its local authority association, an authority could apply for additional allocations for a particular project. But the Government notes that the associations have hitherto been opposed to such an arrangement. Nor does the Government wish to decide priorities as between particular schemes of primarily local significance. Unless the local authority associations wish themselves to decide such issues, making recommendations for supplementary allocations from a reserve held back from the amount otherwise available for basic allocations under the Other Services block, the Government is disinclined to pursue this approach. In Wales, arrangements already exist for dealing with this problem. These arrangements (the projects of regional and national

importance/special projects pool) will continue, subject to agreement with the associations in Wales.

35. The introduction of a new system also provides the opportunity to re-examine the question of resources for authorities obtaining grants from the European Regional Development Fund (ERDF). The national planning total for local authority capital spending already includes an element for the expected level of ERDF receipts. So an authority obtaining ERDF grant does not thereby automatically obtain additional spending power. Were it to do so, a corresponding reduction would have to be made in the resources available for distribution to authorities at national level. This could be done, but inevitably at the cost of reducing spending power for all other authorities. One possible alternative way of matching grant and spending power, if this were generally favoured, would be through a pool system similar to that described in paragraph 34.

36. Schemes where expenditure matches receipt: A local authority may sometimes act as a catalyst in the development of its area. For example it may exercise its compulsory purchase powers in order to assemble land for immediate disposal to a developer, or take a head lease on an industrial estate and then sublet the units. The authority incurs prescribed expenditure on the acquisition of the site, and a capital receipt from its subsequent disposal. But where receipts are subject to a prescribed proportion under the present system, the prescribed expenditure will not be matched by the additional spending power from the receipt in the year in which the expenditure is incurred. Since it is envisaged that under a new system the authority would normally have no spending power from a receipt in the year of disposal, this problem would be exacerbated.

37. As a means of overcoming this problem, the Government proposes that local authorities should not be taken to have incurred prescribed expenditure on the acquisition of interests, whether freehold or leasehold, in land (including buildings and structures) to the extent that an interest conferring the same form of tenure over that land is disposed of within the same financial year to an independent third party creating a receipt which offsets the expenditure. To ensure that such transactions have a neutral effect in public expenditure terms, it would also be necessary to provide

that so far as the proceeds of such a disposal simply offset such expenditure, they would not be treated as capital receipts for the purpose of generating additional spending power in future years.

38. This proposal relates only to cases where under present rules an authority suffers a net loss of resources without in practice holding assets for any appreciable period. Authorities may also assemble land over a period of years for subsequent en bloc disposal; in such cases the authority does for a time hold an asset which could in principle be being used by others, and the normal rules should apply.

39. Compulsory purchase by Government: Similar problems have arisen where the local authority itself has been subject to a compulsory purchase order, for example by the Department of Transport or the Welsh Office for a road scheme. Such a disposal gives rise to a capital receipt, but authorities may not use that receipt in full to justify extra spending to replace the property thus acquired. The problem appears to be limited in extent, but is obviously of some significance to those authorities which are affected. On that assumption, the Government is prepared to consider providing under a gross expenditure control system that where disposal is by way of a compulsory purchase order promoted by a Government department, the proceeds should be available in full to supplement allocations.

40. Direct Labour Organisations: Local authorities have encountered some administrative difficulties over the treatment of direct labour organisations (DLOs) under the present capital control system. The present system views a local authority as a single entity. So it is direct expenditure by the DLO on a contract, including fees, not payments by service accounts to the DLO, which is prescribed. The depreciation and rate of return elements of the DLO's charge are not prescribed expenditure because they do not involve a payment to the outside world, but the renewal of vehicles, plant and equipment by the DLO is prescribed. This treatment does not accord with the principles of DLO accounting. The result is that authorities with DLOs have to maintain two separate records of their expenditure if they want to avoid scoring the full DLO charge unnecessarily as prescribed expenditure.

41. The Government has offered to consider removing this anomaly in any new legislation on capital controls. Barring a substantial change in DLO accounting requirements, which is not envisaged, this would have to mean bringing the capital controls into line with DLO accounting by providing that the DLO charge scored in full as prescribed expenditure. Payments by the DLO would not then be prescribed expenditure. This would put DLOs on all fours with outside contractors, whose asset renewals and profits both have to be covered by their charge to the customer, which in the case of a local authority scores in full as prescribed expenditure. The Government is prepared to make this change if it is favoured by local government. The Government proposes no changes in the rules governing the activities of DLOs.

42. Agency Agreements: The 1980 Act is silent on the treatment of prescribed expenditure incurred under agency agreements. Authorities sometimes enter into agreements to act as agent for another authority, or to act on behalf of a group of authorities including themselves in making payments under a jointly financed scheme. In the first case, the Department has advised that the authority for whom the work is carried out should be taken to score the prescribed expenditure. In the second case, except where otherwise agreed with a Government Department, prescribed expenditure incurred by the authority carrying out the work should be scored against the allocations of all the authorities involved, pro rata to their interest in the project or scheme. This avoids the need to vire resources between the various authorities. Authorities also enter into agreements to carry out works for a non-local authority body, for example the Department of Transport on road schemes or a developer requiring access to such a scheme. In these circumstances no prescribed expenditure is taken to be incurred by the authority. These arrangements would be formalised in any new legislation.

Monitoring

43. Under any new system, the Government will continue to collect information under statutory powers for monitoring local authorities' borrowing and capital expenditure both to ensure the effectiveness

of the control system itself and as part of its general monitoring of the national economy. It may be necessary to collect some information specifically for the latter purpose where national accounts definitions are not identical with those used for control purposes. It would also be necessary to collect some additional information in relation to a new gross capital control system, such as data on accumulated capital receipts and budgetted revenue contributions. The Government is already taking steps to improve its information on accumulated receipts as part of its monitoring of the present system and the information as collected will form a necessary input to the new system.

44. It is apparent from present returns that local authorities' figures for capital expenditure and receipts are subject to revision for some considerable time after the end of the year. Given the use of past receipts figures in determining spending power under the new system, methods of recording these revisions will need to be devised. In addition the possibility of making capital outturn forms subject to certification or audit will have to be considered.

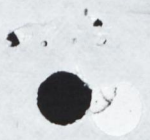
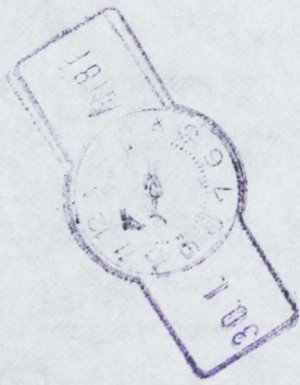
Conclusion

45. Comments are invited on the following points set out in this consultation paper:

- a. the alternative approaches to the setting of annual expenditure allocations under a gross control system (paragraphs 6-8);
- b. the basis on which the spending power from receipts should be calculated, both during the transitional period and thereafter (paragraphs 9-12);
- c. the proposal that borrowing approvals might be set at a level lower than the needs element of allocations (paragraph 14);
- d. the proposed scope to supplement allocations by a limited amount of revenue contributions (paragraphs 17-19);

- e. the future treatment of "non-prescribed" expenditure and capital receipts by virtue of regulations (paragraphs 20-22);
- f. the future treatment of leasing (paragraphs 23-25);
- g. the future treatment of profits generated by local authority trading undertakings (paragraphs 26-27);
- h. the application of capital controls to local authority companies (paragraphs 28-29);
- i. the proposed restriction of advance and deferred purchase schemes (paragraphs 30-31);
- j. the treatment of the other issues discussed in paragraphs 32-42;
- k. monitoring of the new system, including the possibility of requiring certification or audit of returns (paragraphs 43-44).

46. Comments on this consultation paper and on Chapter 6 of the Green Paper should be sent to the Department of the Environment, Room , 2 Marsham Street, London SW1P 3EB or to the Welsh Office, Room 2001, New Crown Buildings, Cathays Park, Cardiff, CF1 3NQ by 14 April 1986. For any enquiries about this paper, please contact Mr A Gall, telephone 01-212-4704.



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The Rt Hon Nicholas Edwards MP

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From The Secretary of State for Wales

6 February 1986

John MacGregor

LOCAL AUTHORITY CAPITAL EXPENDITURE CONTROL

I have seen your letter of 29 January 1986 and enclosures to John MacGregor and am content with what is now proposed.

/ I am copying this letter to the Prime Minister, members of ELF and Sir Robert Armstrong.

NRB

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Ned

The Rt Hon Kenneth Baker MP
Secretary of State for the Environment

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PT 29



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Treasury Chambers, Parliament Street, SW1P 3AG

NBRN.

The Rt Hon Kenneth Baker MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
London
SW1P 3EB

3rd February 1986*Dear Kenneth,***LOCAL AUTHORITY CAPITAL EXPENDITURE CONTROL**

You circulated a draft consultation paper on this subject on 29 January.

The draft reflects discussions between our officials and I am content with the results. I welcome the proposals to tighten up the capital control system and hope the necessary legislation, which the Lord Privy Seal has proposed to QL should be a programme Bill, can be enacted in time to introduce the new control system in 1987-88.

I am copying this letter to the Prime Minister, members of E(LF) and Sir Robert Armstrong.

Yours etc,
John

JOHN MacGREGOR

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RELATIONS
PT 27

