

CEB



2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

14 May 1986

Jim Mm.

LOCAL AUTHORITY CAPITAL EXPENDITURE CONTROLS

We need to look again at the future arrangements for controlling local authority capital expenditure in the light of the responses we have received to the proposals in the Green Paper and the related Consultation Paper.

re-organise? The responses, almost all from local authorities and their representative bodies, may be summarised as follows. The reaction is the same right across the political spectrum:-

a. Few respondents take the External Borrowing Limit (EBL) option seriously. Of those who do almost all reject EBLs as being unworkable.

b. The need for any specific control on the capital side, given rate capping and block grant penalties, is repeatedly questioned. If there must be a control, most respondents accept the validity of a control over new borrowing for capital, as before 1981, but reject anything more.

c. Respondents do not believe that there is a valid economic argument for controlling capital expenditure directly as distinct from total expenditure or borrowing.

d. Still less do they understand the economic justification for constraining authorities in the spending of their own capital receipts. *- but they are not all down*

e. The gross expenditure option is seen as being very repressive. The consequent gain for local authorities in greater stability is either not accepted or seen as being outweighed by the new restrictions. Overall, the proposals are seen as positively unhelpful for sensible capital planning by individual authorities.

f. On the detailed points in the Consultation Paper, there is again much opposition. Dislike is focussed in particular on:-

- restricting the use of accumulated receipts to those backed by cash; we are accused by some of bad faith;

- spoiling the incentive to sell assets by the restrictions on accumulated and new receipts;
- giving borrowing approvals totalling less than 100% of needs-based allocations;
- doubly constraining the freedom to make revenue contributions to capital spending;
- imposing expenditure controls on vehicle and equipment leasing; and
- blocking advance and deferred purchase (though a minority of respondents were in favour of this).

In the light of these responses we must now reconsider the way ahead.

We have to recognise the extreme difficulty of pursuing either of our Green Paper proposals.

First, I do not expect to be able to devise a workable EBL system, however long we wait. Even if we succeeded, it would be no more acceptable to local government than the present system.

Second, in the light of the responses, I am bound to say I see great difficulty in getting through a Bill providing for a gross expenditure control. Naturally, the Opposition would resist it. But more importantly, the majority of our backbenchers might well do so too: the shire district lobby is very powerful; we have not convinced them about the need to control receipts; and the proposed restriction of accumulated receipts to those backed by cash is being seen as renegeing from the assurances given by my predecessor. We would also face difficulty in the Lords, many of whose members have a local government background.

We would also have desperate trouble getting such a Bill through in time for the new system to be implemented by 1 April 1987. It would be at least as controversial as this year's Local Government Act which so narrowly scraped through in emasculated form by that date. At best, we would again have to make major concessions to secure its passage. Rushing the Bill runs the risk of mistakes. We would also have to start to implement it before it became law, because we would need to issue provisional allocations around December to enable local authorities to plan their programmes. All of this is fertile ground for subsequent legal challenges. If we did decide to introduce a gross expenditure control, it may be that the only feasible approach would be to legislate at a slower pace next session for operation from April 1988.

But is it any good going down that road at all unless we can radically improve the public presentation of the fundamental economic case? At present, we cannot convince people that there are good grounds for controlling capital expenditure as a separate aggregate, as distinct from either total local authority expenditure or borrowing. In the Green Paper we mounted a case

*But we
can*

*But - much capital expenditure
is not funded by receipts*

for general control over local authority expenditure as a whole and for influencing the LABR. The replies have focussed on the lack of arguments for a separate control on capital when funded by receipts or revenue. If we cannot produce a much clearer justification we shall never persuade anyone that any separate control system is reasonable. My Accounting Officer, supported by Treasury witnesses, is likely to be examined on just this point on 9 June when the PAC examine the present local authority capital control system.

It is true that the present system, though it may have had some success, has done us enormous political damage. We are seen to be tying ourselves to undeliverable figures on what our supporters regard as shaky economic grounds. But I am very doubtful whether a tight capital expenditure system based on gross expenditure can be sold politically.

Unless we can come up with persuasive economic arguments, our supporters will continue to urge us to look again at the proposition put forward at the outset of these discussions by the local authority associations for focussing control on new borrowing for capital. The similar system which operated before 1981 did not work primarily because loan sanctions, once approved, could be used at any time. With annual approvals, influence over the LABR would be greater. Control of the LABR would be over time rather than on an annual basis, but this is true of the effect on the LABR of any system other than EBLs. Authorities would in general be free to spend capital receipts and revenue contributions as a genuine addition, both locally and nationally, to borrowing approvals, though as a transitional measure I have no doubt that there would have to be restraint on the use of receipts already accumulated, because of the impact which their unbridled use might have on the LABR. Even with that constraint, a borrowing system should prove pretty attractive to local government, and hence to Parliament. It may be the only sort of system which we would have a reasonable chance of getting through at all quickly.

We shall of course need to look at the details of any new system for example to see how we can incorporate in it a measure to prevent the abuse of deferred purchase, to which we are all opposed.

We will need to discuss these issues in E(LF), and they are also relevant to our PESC discussions, on which I shall be writing to you separately next week. You might like a bilateral meeting in the first instance. We need to move quickly, so that we can make an early announcement of our intentions.

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

John M. Baker

KENNETH BAKER

*which is
the system
of capital
receipts*





CONFIDENTIAL

B/G Tuesday 3/6
please
DWS
29/5.

MR NORGROVE

LOCAL AUTHORITY CAPITAL EXPENDITURE
CONTROLS

Thank you for your minute of ~~19~~ May about the Prime Minister's wish to hold a meeting about Mr Baker's letter of 14 May.

In the event, action on your minute was overtaken by the ministerial changes. I understand that Mr Ridley intends to discuss capital controls with his officials next week, preparatory to discussion with the Chief Secretary. Since Mr Ridley's views on the matter cannot be assumed to be the same as Mr Baker's, I would propose, if you agree, to take stock of the situation at the end of next week, and to let you know how matters stand then.

AJC

A J LANGDON

28 May 1986

LOCAL GOVT; Relations; PE 29



BF

file VPo



LOSAA X
a lot Griffiths

10 DOWNING STREET

From the Private Secretary

MR. LANGDON
CABINET OFFICE

LOCAL AUTHORITY CAPITAL EXPENDITURE CONTROLS

The Prime Minister has seen the Secretary of State for the Environment's letter of 14 May to the Chief Secretary describing the response to the Government's proposals on local authority capital expenditure controls. She is most concerned about this, and would see Mr. Baker's alternative proposal for the adoption of loan sanctions controls as a retreat.

The Prime Minister wishes to hold a meeting to discuss this. I imagine that E(LF) will be the right forum. The Treasury will be discussing Mr. Baker's letter with him first. Could you please consider when a meeting should be held, and advise?

DAVID NORGROVE

19 May 1986

JKW

2

PRIME MINISTER

LOCAL AUTHORITY CAPITAL CONTROLS

The alternative capital controls proposed in the Green Paper have been greeted with great hostility. Mr. Baker wants to go back to a system of loan sanctions, with annual approvals, and with transitional controls on use of receipts.

He thinks it unlikely that any other system could be enacted in time to be in operation before April 1988 (which would, among other things, leave the way open for more deferred purchase schemes - see separate letter below).

I suggest await comments.

*We must discuss —
this is a colossal
retreat
no*

DN

DAVID NORGROVE

16 May 1986