

13 January 1983  
Policy Unit

Prime Minister (1)

Would you like to  
mention to the Chancellor before setting  
up a large meeting to set up a PUG?  
MS 15/1

PRIME MINISTER MS 12/1

CAPITAL UNDERSPENDING

I have had a fruitful talk with Tom King, as you suggested.

The underspending may well show little improvement this year. And we cannot repeat our appeal to the local authority organisations and nationalised industries without making the embarrassment worse. We must ourselves find a way to remedy the underspending. Potholed roads and collapsing sewers are poor election propaganda.

1. Tom believes that local authority treasurers will take some time to learn how to handle the unfamiliar volume of receipts from council house sales; and that we cannot exhort them to spend a higher proportion without giving them the wrong signals generally.

His solution is a combination of over-allocation and year-end flexibility. This, he believes, is the only way to overcome the mismatch between local authority income and suitable projects; the local authorities which have the cash may not be the local authorities which have new housing schemes etc. ready to go. General over-allocation and flexibility give headroom for the local authorities which do have such schemes ready.

2. The Treasury's response is: "But what would happen if every local authority spent up to its over-allocation and carried forward its unspent cash to the next financial year? All our painfully won gains in the control of local authority expenditure would be thrown away". In any case, over-allocation would not eliminate underspend this year.

3. How can we resolve this deadlock between the Treasury and Department of the Environment? Geoffrey Howe's officials suggested one method in their paper of 13 December for the pre-Christmas unemployment meeting (response to f(v)(b)). It is worth repeating this suggestion, as we did not discuss it on 23 December:

"... special measures such as labour-intensive construction contracts are more difficult to control as to employment and timing. In addition it is difficult to set these in hand without giving the wrong signals to local authorities and other public sector bodies about the Government's determination to control

public expenditure. If Ministers wanted to stimulate more public sector capital spending of a labour intensive kind, room would first have to be found by some shift of priorities within agreed public expenditure programmes. Then relevant spending authorities (eg regional water authorities, local authorities, perhaps NHS and PSA) would need to be invited to put forward additional projects for labour-intensive investment, with estimates of jobs created. If these applications were approved, authorities' capital allocations might need to be adjusted, and some cost-per-job subsidy might also be needed as an incentive to authorities to co-operate. An agency would be needed to run the scheme, and MSC would be the obvious choice (it already deals with local authorities on some of its existing schemes). But Ministers would first need to decide whether they wished to loosen restraints on capital spending and divert resources into a 'public works' scheme of this kind."

In other words, the Treasury proposes a back-door or by-pass solution:

- (i) The selected projects would be approved outside the normal Whitehall-town hall machinery, and would not affect capital allocations generally, and so would not send the wrong signals to local government (any more than grants from the European regional funds send the wrong signals).
- (ii) The Treasury would retain control of the size of the total pool available for this purpose.
- (iii) The agency running the scheme would be able to ensure that the projects were essential works which would have to be carried out at some time.
- (iv) The scheme would be short-term and temporary, until underspend had been eliminated and local authorities had to come to spend up to their capital allocations again.

If you feel that the MSC could not or should not cope, you might prefer an interdepartmental Project Underspend Group drawn from Treasury (to count the cash), MSC (to assess the employment implications) and DoE and DoI (to assess whether the schemes themselves were truly essential).

A PUG could be set up overnight and (just as important) disbanded overnight.

If you think a PUG scheme is worth considering, would you like a meeting with the Chancellor, Tom King and Patrick Jenkin and David Young to consider the practicalities?

+ Welsh + Scottish Secretaries?

+ Mr Tebbit?

+ Chief Secretary?

+ Mr Fowler if, as suggested, the

NHS is to be involved?

FERDINAND MOUNT

Yes - should prefer the MSc  
to attach to the Treasury  
to control

not