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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Nicholas Ridley AMICE MP
 Secretary of State for the Environment
 Department of the Environment
 2 Marsham Street
 London
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NBM
 20 November 1987

Dear Secretary of State,

DOE/LA1 END-YEAR FLEXIBILITY

Thank you for your letter of 21 October proposing that we should announce extra capital allocations for local authorities for 1988-89, under the end-year flexibility (EYF) rules, because of the likely underspend on the relevant cash limit DOE/LA1 in 1987-88. I have also considered Kenneth Baker's and Paul Channon's letters supporting your proposal.

The forecast underspend on DOE/LA1 this year does not arise from any shortfall in gross capital spending; on the contrary, total expenditure is projected to exceed gross provision. Rather the underspend stems from higher capital receipts, a reflection of the success of our policies in encouraging asset sales. In the circumstances, I am reluctant to concede higher capital provision for local authorities in 1988-89 than we agreed in the Survey and announced earlier this month.

However I understand your Department's lawyers advise that the wording of the relevant DOE circular 5/87 in effect requires us to increase the amount available for allocation the following year if we take the view in the autumn that an underspend is likely. The implied lack of Ministerial discretion is highly unsatisfactory; and in view of this advice, we will need to consider the rules for EYF on this cash limit further.

will request if required

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But the immediate difficulty is that local authority associations are now aware of the projected underspend on DOE/LAL in 1987-88. I do not believe there is a case on merits for going beyond the total gross provision for LA capital announced in the Autumn Statement; but we clearly need to take into consideration the risk identified by your Department's lawyers of successful legal challenge if we do not acknowledge that the EYF arrangements set out in the circular will apply.

I am reluctantly driven to the conclusion that, on balance, it is probably better to accept that the principle of EYF will apply than to risk successful legal challenge. But before confirming my agreement to this, I have two particular concerns on which I would wish to be satisfied. These relate to the maximum amount of extra allocations under EYF, and the timing of their announcement.

In setting the amount we need to take into account the small overspend on the cash limit in 1986-87. Paragraph 61 of Circular 5/87 recognises that where the size of the breach is uncertain at the end of the year, the cash limit penalty may be applied a year later. I therefore propose that the £18.5 million overspend in 1986-87 should be netted off the EYF figure for 1987-88. Also these extra allocations will be a charge on the 1988-89 Reserve and effectively an in-year change. The rule is therefore that each £1 allocation should score as £1 on provision and the cash limit (not at the higher rates of allocations to provision used in the Survey). Accordingly when the amount available for allocations in 1988-89 under EYF is announced it should be on the basis of a 1:1 ratio between cash limit provision and allocations. At its maximum it would therefore mean an additional amount for allocation of £123.2 million (5 per cent of EYF 1987-88 equal to £141.7 million less £18.5 million overspend in 1986-87).

We also need to consider the distribution of the revised total of allocations to service blocks. In this context, we need to keep in mind the need to make provision for capital spending falling in 1988-89 to remedy storm damage. Within this total, I therefore propose that you set aside a sum sufficient to cover allocations needed for this purpose. You and colleagues in departments will be best placed to judge what this amount should be on the basis that I will not be willing to agree any further allocation subsequently. The remainder of the £123 million should be distributed to departments in proportion to net provision.

Finally, on timing, you will appreciate that the Chancellor and I are bound to be very concerned about any announcement which implies a significant claim on the Reserve in advance of publication of the Public Expenditure White

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Paper, planned for mid-January. We must avoid the embarrassment of being seen to raid our own Reserve before the figures are published. I should be grateful therefore if you would defer an announcement of the precise figures for extra allocations and their distribution, until after publication of the White Paper. You will in any case wish to consider the second quarter figures and allocations for storm damage before agreeing the final figures.

I very much hope you can meet my concerns about timing, and that you and colleagues are content with what I propose on the amount and distribution of extra allocations. If so, I for my part would be prepared to accept that the principle of EYF should apply to the expected underspend this year, and that if necessary you should indicate this publicly in responding to questions that may arise from the first quarter figures.

I am copying this letter to Willie Whitelaw, other members of E(LF) and Sir Robert Armstrong.

Yours sincerely,

Jim Rutherford

pp JOHN MAJOR

(Approved by the Chief Secretary
and signed in his absence).

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cc 8G

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NBRM.

27 October 1987

Mr. John,

DOE/LAI CASH LIMIT: END YEAR FLEXIBILITY

Nicholas Ridley's letter to you of 21 October proposed that the end-year flexibility (EYF) arrangement which is part and parcel of the local authority capital controls should operate in respect of the expected underspend of the 1987-88 cash limit. Your letter of 23 October appeared to cast doubt on the appropriateness of this.

will request if required.

I strongly support the arguments Nicholas puts forward for implementing EYF - although I cannot agree with his suggestion for distributing the extra allocations. We could not defend the abandonment of EYF when we have every reason to suppose that the cash limit is heading for a large underspend, having confirmed the arrangements as recently as March this year with specific reference to 1987-88.

As to the distribution of allocations between services if, as I hope, you agree to retain EYF, it is essential that education should benefit. There is no defensible basis for omitting education from the prospective additional allocations, since as you are aware the attribution of provision between services is out of line with the realities. What is more, education receipts have been coming in at a substantially higher level than was forecast, with the result that the "overspend" on education which is an automatic consequence of the maldistribution of provision is in fact forecast to be lower in 1987-88 than the figure we

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anticipated for the current year and which we took into account in our PES discussions. If there are to be additional allocations, the basis for their distribution needs to be agreed among us.

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

Tommy
Armstrong