



Prime Minister's copy.
Mr. Ridley's approach is supported by the Policy Unit (note below).

Content:

- ① To accept that no change would be appropriate under the present regime.
- ② To note that the new regime does give authorities greater freedom to spend in the first year?

PRIME MINISTER

THE PRESCRIBED PROPORTION OF CAPITAL RECEIPTS

At E(LF)(88)4th meeting, I was invited to circulate a note on the extent to which local authorities should be allowed to spend capital receipts in full within the financial year in which they are received.

The present capital control system does not, in England and Wales, discriminate between in-year and accumulated receipts. Local authorities may in any financial year use the prescribed proportion of their capital receipts (in-year and accumulated) to finance new capital expenditure. The prescribed proportion is (in England) currently 20% of receipts from sales of council houses and 30% of most other receipts. The effect of this restriction is that the non-prescribed proportion of an authority's receipts must be put on deposit, ie either lent back to the private sector or used as substitute for other public sector borrowing. In either case, the net PSBR is reduced. For every £100 of receipts available to an authority in a given year, the prescribed proportion (say £30) may be spent, but the remaining £70 goes to offset the PSBR. (In Wales different proportion - 15% for sales of council houses and 50% for most other receipts - have been prescribed.)

This restriction cannot be removed under the present legislation (part VIII of the Local Government, Planning and Land Act 1980). Whilst different proportions can be prescribed by regulation for different classes of assets, the legislation does not permit in-year receipts in any given year to be treated differently from accumulated receipts carried forward in that year. Nor is it possible to vary the proportion by reference to the purpose to which the receipt is proposed to be applied.

mt

Yes

attached

Yes

Phc/b
15/6



It seems unlikely that it would be practicable to amend the existing primary legislation, to allow 100% use of in-year receipts under the present system, in advance of bringing forward legislation on the proposed new capital control system. Even if it were, such a change would be undesirable, for two main reasons. First, if it were allowed to generate additional spending power it would exert significant upward pressure on the PSBR. The non-prescribed proportion of in-year capital receipts is expected to amount to some £1.9 billion in 1989/90 in England alone. Although allowing this money to be spent would be neutral in the sense that the expenditure would be offset by receipts, it would not be neutral in comparison with the present arrangements.

Secondly, if these receipts were not permitted to generate additional spending power, the result would be to exacerbate the mismatch between needs and resources which is one of the major problems with the present capital control system. In order to contain total capital spending at planned levels, the amount forecast to be available for spending from receipts is deducted from the planning total before allocations are issued to authorities. The 1980 Act does not, however, permit us to take account when issuing allocations of authorities' ability to finance expenditure from receipts. As a result, those authorities which have generated the greatest receipts have accumulated spending power disproportionate to their assessed needs, at the expense of the rest of local government. Reducing the amount available for allocation, to take account of the full use of in-year receipts, would disadvantage still further those authorities with the least scope to achieve capital receipts.

I should note that in Scotland, under different legislation, 100% use of in-year receipts is allowed. Local authority receipts there are, however much lower compared with allocations, so the degree of mismatch is correspondingly less.



I therefore believe that it would be inadvisable to allow full use of in-year capital receipts, under the system now operating in England and Wales, even if an early opportunity to amend the 1980 Act were to present itself. With the Chief Secretary's agreement I have, however, now announced an alternative means of facilitating schemes aimed at the rationalisation of local authority assets. Additional capital allocations will now be made available to cover:-

- i. exchanges of land for land;
- ii. the replacement of existing assets held by local authorities by assets to be used for a similar purpose;
- iii. schemes in which the main intention is to facilitate investment by the private sector in assets which when the scheme is complete will be owned, operated and controlled by the private sector.

Under the proposed new capital control system, the same difficulties over the use of receipts will not arise. We will, when issuing credit approvals, be able to take account of the ability of authorities to finance expenditure from receipts. Moreover, authorities' access to their receipts will be subject only to the requirement that a specified proportion of the proceeds from the disposal of assets should be applied to debt redemption or set aside to meet future capital commitments. They will be free to spend the remainder in the first or subsequent years as they see fit.

I am sending copies of this minute to the other members of E(LF) and to Sir Robin Butler.

NR

14 June 1988

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10 DOWNING STREET
LONDON SW1A 2AA

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CBG

From the Private Secretary

16 June 1988

Dear Roger,

**THE PRESCRIBED PROPORTION
OF CAPITAL RECEIPTS**

The Prime Minister was most grateful for your Secretary of State's minute of 14 June. She accepts that it would not be appropriate to make any change under the present regime and has noted that the new regime will give authorities greater freedom to spend receipts in the year in which they are received.

I am copying this letter to the Private Secretaries to members of E(LF) and Trevor Woolley (Cabinet Office).

*Yours,
Paul*

PAUL GRAY

Roger Bright, Esq.,
Department of the Environment

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PRIME MINISTER

15 June 1988

PRESCRIBED PROPORTION OF CAPITAL RECEIPTS

Nicholas Ridley has sent you his promised note on whether local authorities should be able to spend capital receipts in full in the year in which they are generated. You thought this might be acceptable because the expenditure and the receipt would cancel with no net effect on public expenditure.

In fact, as the note explains, this would not be so. At present the full capital receipt scores as negative public expenditure in the year in which it arises but local authorities are only allowed to spend a proportion. Allowing them to spend the whole receipt would increase gross expenditure and, since there would be no change in receipts, also increase net expenditure. It is possible that there would be some incentive effect encouraging local authorities to generate additional receipts but if most of these were spent in-year, there would probably be no significant offsetting reduction in public expenditure.

The only way under such a system to avoid increasing public expenditure would be to reduce the total of allocations available to local authorities. But this would exacerbate one of the problems with the present system - that there is so much spending power from receipts and we have insufficient to distribute in allocations.

Under the new capital control system local authorities would be required to use a proportion of receipts to redeem debt. This is a key feature of the new system and we therefore could not allow local authorities to spend in-year receipts in full.

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Conclusion

We suggest that you agree with Nicholas Ridley's
recommendation not to allow local authorities to spend
in-year receipts in full.

Peter Stredder

PETER STREDDER

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ST. ANDREW'S HOUSE
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The Rt Hon Nicholas Ridley AMICE MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
LONDON

MSBM

*REC 6
23/6*

23 June 1988

Dear Nicholas,

LOCAL AUTHORITY CAPITAL EXPENDITURE IN ENGLAND AND WALES :
PRESCRIBED PROPORTION OF CAPITAL RECEIPTS

Thank you for copying me your ^{at flag} minute of 14 June to the Prime Minister. I have also seen copies of PS/No 10's ^{at floor} minute of 16 June and Peter Walker's minute of the same date.

As you know, I wrote to you on 28 March and 16 June agreeing to the new capital expenditure control arrangements for England and Wales and to the issue of your proposed consultation paper. The recommendation in your minute of 14 June causes me no difficulty and I am content with your conclusion.

Your minute says about Scotland:-

".... 100% use of in-year receipts is allowed. Local authority receipts there are, however, much lower compared with allocations, so the degree of mismatch is correspondingly less."

This is not quite right and I think it is important to clarify what may be a misleading impression about the main features of the existing Scottish system.

What it should have said was that, end-year flexibility apart, any spending of capital receipts must be in the year they are received. In this way we have not permitted the accumulation of a massive overhang of unused receipts and do not have the problem of the cascade. It is the case, as you say, that the level of capital receipts generated in Scotland is considerably smaller than in England, but this is irrelevant to my arrangements for the distribution of resources against local authority need. I can, and do, take estimates of an individual authorities' receipts into account in setting its capital allocations. As in England and Wales, some authorities are better placed than others to generate receipts but my existing arrangements - like your proposed new system - allow me to take account of this and enable me to aim for the most effective distribution of available resources while still maintaining some incentive to disposal of assets.

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Copies of this letter go to the Prime Minister, members of E(LF) and Sir Robin Butler.

*Yours ever,
Malcolm*

MALCOLM RIFKIND

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