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 ABPM did not
 respond.

Treasury Chambers, Parliament Street, SW1P 3AG

filed

2/11

The Rt Hon Nicholas Ridley AMICE MP
 Secretary of State for the Environment
 Department of the Environment
 2 Marsham Street
 London
 SW1P 3EB

2 November 1988

Dear Secretary of State

**LOCAL AUTHORITY CAPITAL EXPENDITURE:
 CASH LIMITS AND END YEAR FLEXIBILITY**

I understand from my officials that we have the prospect of another massive net underspend this year, possibly of the order of £½ billion, on the main cash limit for local authority capital expenditure in England (DOE/LA1). The prospective net underspend is made up of a large overspend on gross provision, of the order of £850 million, offset by an addition of over £1600 million to projected receipts.

The end year flexibility regime for this cash limit, unlike those generally applying to departments, is based like the cash limit itself on expenditure net of receipts and not on gross expenditure. As things stand, therefore, we should be obliged on the above figures, this year as last year, to reward local authorities by conceding substantial additional capital allocations. I understand that the cost on this occasion would be likely to be some £135 million, charged to the 1989-90 Reserve.

It is, I think, beyond doubt that we must act swiftly so as to remove any obligation to give local authorities this end year flexibility bonus. I do not see how we could again defend giving them extra capital allocations when they are likely to have overspent their 1988-89 gross provision by the large margin mentioned above; when they will continue over the next 18 months to have an unprecedented level of accumulated receipts and unique incentives to spend them; and when they have never been properly penalised for overspending their cash limits in the past.

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More generally, I think it is clear that, given the large and unpredictable levels of receipts from RTB sales, a control system based on expenditure net of receipts no longer makes much sense. It means that the more successful our own policies are, the more freedom local authorities have to increase their expenditure.

In the medium term, we are tackling these problems through our proposals for the new capital control system for local authorities. The immediate question is what action we can best take to avoid giving local authorities further unjustified end year flexibility bonuses over the next 18 months.

Officials have concluded after studying the matter that the best solution will be to discontinue the DOE/LAI cash limit, and the penalty and end year flexibility arrangements associated with it, for this year and next. I agree with this conclusion. For consistency, we would need similarly to discontinue the WO/LAI cash limit in Wales.

In taking this step, we would need to make quite clear that in no sense are we retreating from our policy on cash limits. To that end I suggest we should announce simultaneously that with effect from 1990-91, when the new public expenditure planning total and local authority capital control systems are to be introduced, the Government proposes to impose cash limits on sources of finance for local authority expenditure which fall within the new public expenditure planning total. So far as the intervening period is concerned, we would need to emphasise that a cash limit applied to expenditure net of receipts no longer makes any sense as an instrument of control in present conditions.

Subject to any points which Patrick Mayhew may have, I would hope that the solution we have in mind would not involve any serious risk of legal challenge. Local authorities may be somewhat disappointed anyway by our decision to continue with the policy of cutting capital allocations, and we cannot exclude the possibility that they might consider challenging our proposed solution on grounds of legitimate expectations. Their argument would have to be that the existing DOE circular provides for a cash limit system with end year flexibility as well as penalty provisions; that the Government issued £75 million in extra allocations last November because of the net underspend in prospect on the cash limit for 1987-88; and that the Government later gave a further £141.7 million in allocations under the end year flexibility scheme itself. For 1988-89, local authorities are already aware, from the projections in their own capital expenditure returns reported to the Capital Programmes Working Party in July, that a net underspend is in prospect for 1988-89, and the Autumn Statement tables will confirm this. Local authorities might therefore seek to argue that they have a right to expect at least end year flexibility allocations this year.

Against that, however, end year flexibility allocations are in the nature of a bonus from the point of view of individual authorities; and our proposal to have no cash limit or end year flexibility this year or next would have an upside for local authorities in 1989-90 (no penalties in case of a net overspend)

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as well as a downside for this year (no end year flexibility bonus). To minimise the risk of challenge, I believe our announcement should (as suggested above) underline the unsatisfactory nature of the cash limit itself in present circumstances (a point which the PAC have already made) and make it clear that we intend to consult the Local Authority Associations in the usual way.

... If you feel, as I imagine you will, that it would be more apposite for the Treasury than DOE to make the announcement, I would propose to arrange a written question and answer for issue on Tuesday of next week, 8 November. A draft is attached.

With apologies for the short notice, I would be grateful to receive any comments from colleagues by close on Thursday. I hope I may assume, unless I hear to the contrary, that colleagues who have not commented by then will be content to proceed in the way suggested.

I am copying this letter to the Prime Minister, Nigel Lawson, Peter Walker, Malcolm Rifkind, Patrick Mayhew, Douglas Hurd, Kenneth Baker, Paul Channon, Kenneth Clarke and John MacGregor, and to Sir Robin Butler.

Yours sincerely

Carly Evans

JOHN MAJOR

*(approved by the Chief Secretary
and signed in his absence)*

DRAFT ARRANGED WRITTEN QUESTION AND ANSWER

M...to ask Mr Chancellor of the Exchequer what plans he has for cash limits on local authority capital spending.

MR JOHN MAJOR

As already announced, the Government plans to introduce with effect from 1990-91 the new public expenditure planning total set out in Cm441 and, subject to the approval of Parliament, a new system to regulate the capital finance of Local Authorities in England and Wales about which my Rt Hon Friends the Secretaries of State for the Environment and Wales have consulted local government. The Government's broad intention is that, with effect from 1990-91, cash limits should be applied to the sources of finance for local authority capital expenditure which fall within the new planning total. The main existing cash limits on local authority capital spending in England and Wales (DOE/LA1 and WO/LA1) apply to expenditure net of receipts. With the recent surge in receipts, and given the difficulties of predicting future levels of receipts, these cash limits are no longer appropriate as instruments of financial management and control. Subject to consultation with the Local Authority Associations, therefore, the Government proposes that these cash limits, and the associated end-year flexibility and penalty arrangements, should be discontinued with effect from the current financial year.

cc P/L



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My ref:

Your ref:

The Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

3 November 1988

ABM

ALG

3/11

Dear John

LOCAL AUTHORITY CAPITAL EXPENDITURE
CASH LIMITS AND END YEAR FLEXIBILITY

Thank you for your letter of 2 November.

Subject to what follows, I am content with your proposal to discontinue the DOE/LAL cash limit and the associated end year flexibility and penalty arrangements and with the terms of the written question and answer which you suggest.

Your officials will have drawn your attention to legal advice that we should not take any firm decision until after the Local Authority Associations have been consulted. It would be desirable for a Treasury paper to be circulated to the Capital Programmes Working Party simultaneously with the announcement. Please could your officials ensure that this paper is with the Secretariat of the Working Party by Monday afternoon.

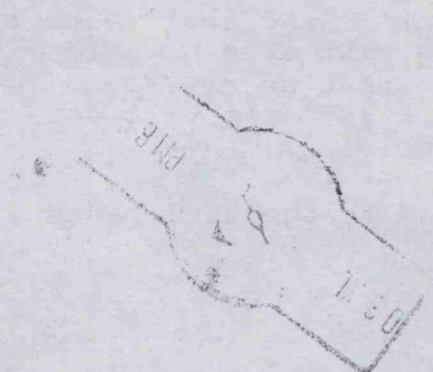
It is important that we should make clear that there is indeed an "upside" for local authorities as well as a downside. The Treasury paper should therefore make clear that an overspend in 1989-90 against what would have been the cash limit will not result in penalties in 1990-91 (or any later year).

I am sending copies of this letter to the recipients of yours.

*James
Nicholas*

NICHOLAS RIDLEY

LOCAL GOVT: Relations PT36.





01-936 6269

The Rt. Hon. John Major MP
Chief Secretary
HM Treasury
Parliament Street
LONDON SW1P 3AG

ROYAL COURTS OF JUSTICE
LONDON WC2A 2LL

4 November 1988

Dear Chief Secretary

LOCAL AUTHORITY CAPITAL EXPENDITURE:
CASH LIMITS AND END YEAR FLEXIBILITY

You copied to Patrick Mayhew your letter of ~~2~~ November to Nicholas Ridley in connection with your proposal to discontinue the present system of cash limits and associated end year flexibility and penalty arrangements, with effect from the current financial year.

Although there is a statutory framework, in Part VIII of the Local Government Planning and Land Act 1980, for the control of local authority capital expenditure, the fixing of the global cash limit and the determination of the amounts of allocations to local authorities for particular financial years is entirely for the Ministers concerned. The existing bonus and penalty system is purely administrative in character, but it has been in place since 1983 for local authority capital expenditure and the principles by reference to which it is operated are published, currently in DOE Circular No.5/87.

It is clearly arguable that the published statement of principles, together with past practice in earlier years, provide the basis for a legitimate expectation by local authorities that the existing system will continue in operation throughout this financial year and for the purpose of fixing the relevant cash limits for 1989-90. I therefore see some likelihood that certain authorities which have been expecting this year's net underspend to be reflected in an enhancement of next year's cash limits will, when they discover that the rules are to be altered, seek to challenge the change by way of judicial review.

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The doctrine of legitimate expectation is still a relatively undeveloped area of law, the precise boundaries of which are presently unclear, so that there must, in my judgment, at least be some risk that a challenge based on that doctrine might succeed. Nevertheless, provided that any final decision to discontinue the existing system is preceded by early consultation in the way you propose, the Government would have strong arguments to deploy in any judicial review proceedings which may be mounted. An early announcement of your proposals, followed by an effective consultation of those likely to be affected by the change, will deprive disgruntled authorities of any argument that they had set their 1989-90 budgets in the expectation that their allocations would be increased to reflect this year's net underspend. In any event, no individual authority would be in a position to quantify its expectation for budgeting purposes before it had been given its own allocation under the global cash limits. There is, moreover, built into the existing principles set out in Circular 5/87 a statement that, in the event of an underspend, Ministers will "if appropriate, increase the amount available for allocation in the following year". Those words in themselves arguably confer a wide measure of discretion in the exercise of which Ministers may properly take the view that it would appear absurd to increase allocations against the background of a large overshoot in gross expenditure for the second year running.

In the light of these considerations it is my view that if, after appropriate consultation, the Government should decide to discontinue the existing system of cash limits and end year flexibility, any challenge to that decision by way of judicial review could probably be defeated.

I am sending a copy of this letter to the Prime Minister, Nigel Lawson, Peter Walker, Malcolm Rifkind, Nicholas Ridley, Douglas Hurd, Kenneth Baker, Paul Channon, Kenneth Clarke and John MacGregor, and to Sir Robin Butler.

Yours sincerely
Peter Lyell

AP NICHOLAS LYELL

(Approved in draft by the Solicitor General
and signed in his absence)

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Oddai wrth Ysgrifennydd Gwladol Cymru



NBM

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From The Secretary of State for Wales

THE RT HON PETER WALKER MBE MP

4 November 1988

NB 2 pps

Dear Chief Secretary

LOCAL AUTHORITY CAPITAL EXPENDITURE
CASH LIMITS AND END YEAR FLEXIBILITY

You copied to me your letter of ^{as/lop} 2 November to Nicholas Ridley.

I accept that there is no merit in preserving cash limits under a flawed control system which we are in the process of replacing. I am therefore content for WO/LA1 to be abolished and for the announcement to be made by you in answer to a written PQ as suggested.

Copies of this letter go to the Prime Minister, Nigel Lawson, Nicholas Ridley, Malcolm Rifkind, Patrick Mayhew, Douglas Hurd, Kenneth Baker, Paul Channon, Kenneth Clarke and John MacGregor and to Sir Robin Butler.

Yours sincerely
A Clement

Approved by the Secretary of State
and signed in his absence

Rt Hon John Major MP
Chief Secretary to the Treasury
H M Treasury
Parliament Street
London SW1

LOCAL GOVT: relation p 36.





HOME OFFICE
QUEEN ANNE'S GATE
LONDON SW1H 9AT

cc PU

4 November 1988

Dear Caryl,

NBPM

AKC

2/11

**LOCAL AUTHORITY CAPITAL EXPENDITURE:
CASH LIMITS AND END-YEAR FLEXIBILITY**

^{at Pop} The Chief Secretary copied to the Home Secretary his letter of 2 November seeking a response by 3 November. I passed the gist of this to your office on the telephone.

We are not opposed to the Chief Secretary's proposals and are content with the terms of the announcement. As you will be aware, we have recently issued a consultation document on the treatment of law and order services under the proposed new capital controls system. It is important that if the point arises it is made clear that the cash limiting of law and order services capital expenditure is still under consideration.

Copies of this go to the Private Secretaries to the recipients of your letter.

Your sincerely,

Nick

N C SANDERSON

Miss G C Evans
Private Secretary to
the Chief Secretary

LOCAL GOVT: relations pt 36

