cll

E(LF)(O)(85) 7 COPY NO 26

2 December 1985

CABINET

STEERING COMMITTEE ON LOCAL GOVERNMENT FINANCE STUDIES

DRAFT GREEN PAPER ON LOCAL GOVERNMENT FINANCE

Note by the Secretaries

1. Enclosed is Chapter 6 of the draft Green Paper. This has not yet been seen by Department of the Environment Ministers.

2. Could drafting comments be sent, as soon as possible, to Ian McBrayne, Room N4/08, Department of the Environment. It is not proposed to discuss the Chapter in E(LF)O. But if any Department would like a separate meeting to discuss it, could they tell Ian McBrayne (on 212 4710) who will set in hand the arrangements.

Signed J E ROBERTS
D P WALKER
J RUTTER

Cabinet Office
2 December 1985

CONFIDENTIAL

(Version of: 29 November 1985)

CHAPTER 6: CAPITAL EXPENDITURE

Introduction

6.1 This Green Paper has focussed so far on local authority revenue expenditure, that is spending financed out of "current income", and on the means of providing that income. But local authorities also spend around £5bn a year in England and Wales, or £100 per person on capital expenditure. This includes the purchase and construction of new buildings, roads and other structures; major renovation and improvement works the acquisition of land, vehicles, plant and equipment; and the making of grants and advances to other people for similar purposes, including mortgage loans for house purchase. Such spending accounts for only about % of all local authority spending, but it lays the foundations for the future provision of local services. This chapter deals with the system for controlling such expenditure in England and Wales: a separate system operates in Scotland and there are no plans for major changes there.

Borrowing and borrowing controls

6.2 Because capital expenditure offers future as well as immediate benefits, local authorities are not necessarily expected to finance it, as they are revenue expenditure, from income in the year. A large part of capital expenditure has always been financed out of borrowing . The period over which local authorities are allowed to repay the loans is related to the expected life of the new asset. In this way, capital projects are paid for through their lifetime by those who benefit from them.

6.3 Local authorities all operate a consolidated loans fund (CLF). When a service account needs to borrow money, for example to pay for the renovation of council housing, it turns not to external sources such as banks but to the local authority's own internal CLF. The treasurer, who runs the CLF, is responsible for finding the money to lend. If necessary, he will turn to the Public Works Loan Board, a government-funded body which lends only to local authorities, or to the money market. But if possible he will instead draw on money which is temporarily spare in some other part of the local authority: it may come for example from the sale of a piece of land or from the arrival of rate income or a tranche of government grant. This saves paying interest to outside lenders. Later, when that money is required for other purposes, the CLF may need to borrow externally to replace it.

6.4 Since such a large part of capital spending is financed by borrowing, the government has to be concerned not only with the level of spending itself, as with revenue expenditure, but also with the implications for the overall public sector borrowing requirement (PSBR), of which the local authority borrowing requirement (LABR) forms a part. The government has exercised some form of control over local authority borrowing for at least 150 years.

6.5 During the 1970s it became increasingly clear that the form of borrowing control then being operated by the government offered too little influence over either expenditure or borrowing. Local authorities were free to achieve any desired level of expenditure by the application of any amount of non-loan finance over and above their borrowing limits. On the borrowing side, the control covered borrowing for capital purposes by service accounts from the CLF, regardless of whether the money was initially found from external borrowing or by the temporary application of surplus funds from elsewhere in the local authority. Borrowing approvals were mostly given for particular projects, and the initial borrowing from the CLF could take place either immediately the approval was given or in any subsequent year, depending on how fast the project progressed. Where the CLF initially used surplus internal money to make the loan, external finance could be substituted at any later date. There was a further complication: although local authorities are not allowed to borrow long-term for revenue expenditure, they may borrow short-term while they wait for money which is due to come in; such borrowing was outside the specific controls and varied considerably in amount from year to year. Taking all these points together, government influence over the level in any given year of the LABR, which measures changes in the level of local authorities' external borrowing, was very limited despite the controls.

The 1981 system

6.6 On taking office in 1979, the present government decided that in parallel with its reform of the block grant system it should tackle the problems on the capital side. The solution adopted was to introduce for the first time a system of direct controls over the level of capital expenditure. The system was embodied in the Local Government, Planning and Land Act 1980 and came into force from the financial year 1981/82.

6.7 At the national level, cash limits are set on the total of local authorities' net capital expenditure. The level of net expenditure in a given year is measured by taking the overall gross level of expenditure that year and subtracting the amount of capital receipts accruing in the year from the sale of council houses, surplus land and other assets and from the repayment to local authorities of mortgages and other grants and advances. At local level, each local authority is given capital expenditure allocations by the government each year. In England, local authorities receive a number of such allocations, each covering a particular block of services. In Wales, a single block allocation is given, but separate allocations are given for some major schemes. Allocations constitute permission to incur a stated level of capital expenditure. Each local authority may aggregate all its allocations and add to them in various ways, most importantly by taking into account a specified proportion of its capital receipts. This includes both receipts arising in the year and those remaining unspent from earlier years. In this way, an individual authority's expenditure ceiling can be considerably greater than the level of its allocations. But the ceiling once set is a ceiling on all capital spending, except for a few exempt categories: direct contributions from revenue may be used to finance spending up to the ceiling, but can no longer justify additional spending above it.

6.8 This system had various objectives:

i. It was intended that it should provide greatly improved government influence over aggregate levels of local authority capital expenditure and borrowing. The setting of direct expenditure ceilings for individual local authorities for the first time was designed to keep national spending within the cash limits. A much simplified form of borrowing control was also kept, in which approvals are set at a level equal to each authority's expenditure allocations, subject to certain adjustments, and are exercisable only in the year to which they relate. This restriction was designed to remove one of the elements of uncertainty inherent in forecasting the LABR.

ii. It was intended that the system should promote the government's aim of reining back the public sector by encouraging asset sales. For this reason local authorities are allowed to use a proportion of the proceeds of such sales on new capital expenditure at their own discretion. This policy was related closely to the Right to Buy policy for council house tenants enshrined in the Housing Act 1980.

iii. At local level, it was intended that the system should provide a stable basis for local authorities to plan their capital programmes. It was also intended that the government would allocate resources in accordance with national policies, but that local authorities should have freedom, within their overall spending ceiling, to choose the projects on which they would spend to fit with local priorities. Although in England allocations are given in service blocks, (housing, education, transport, personal social services, urban aid and 'other services') complete freedom of virement is allowed between blocks. Allocations can also be transferred from one local authority to another.

6.9 The system has not achieved the first objective. The very success of the Right to Buy policy and other moves to secure the sale of surplus assets has left local authorities with a large store of accumulated capital receipts available to enhance spending expenditure ceilings for individual local authorities for the first time was designed to keep national spending within the cash limits. A much simplified form of borrowing control was also kept, in which approvals are set at a level equal to each authority's expenditure allocations, subject to certain adjustments, and are exercisable only in the year to which they relate. This restriction was designed to remove one of the elements of uncertainty inherent in forecasting the LABR.

ii. It was intended that the system should promote the government's aim of reining back the public sector by encouraging asset sales. For this reason local authorities are allowed to use a proportion of the proceeds of such sales on new capital expenditure at their own discretion. This policy was related closely to the Right to Buy policy for council house tenants enshrined in the Housing Act 1980.

iii. At local level, it was intended that the system should provide a stable basis for local authorities to plan their capital programmes. It was also intended that the government would allocate resources in accordance with national policies, but that local authorities should have freedom, within their overall spending ceiling, to choose the projects on which they would spend to fit with local priorities. Although in England allocations are given in service blocks, (housing, education, transport, personal social services, urban aid and 'other services') complete freedom of virement is allowed between blocks. Allocations can also be transferred from one local authority to another.

6.9 The system has not achieved the first objective. The very success of the Right to Buy policy and other moves to secure the sale of surplus assets has left local authorities with a large store of accumulated capital receipts available to enhance spending power. This, together with two serious flaws in the drafting of the legislation which governs the system, has made it impossible to control expenditure accurately on an annual basis. In the first two years, as receipts started to come in fast and local authorities were adjusting to the new system, there was considerable underspending of the national cash limits. But in the three years from 1983/84 there has been persistent overspending.

6.10 The government has made changes in the system to deal with the problem of overspending, but these changes have made the other objectives more difficult to achieve. The main step has been to reduce the spending power from receipts without a compensating increase in allocations. This has helped to offset the growing spending power from the stock of accumulated receipts, but it has also reduced the incentive to dispose of surplus assets and the scope for directing allocations at areas of greatest need. This and other corrective action has left local authorities uncertain about the details of the regime for future years, and this has been a hindrance to them in their forward planning which has been only partly offset by advance indications of minimum allocation levels for some service blocks.

Towards a new system

6.11 In the autumn of 1984 the government undertook to review the system in consultation with the local authority associations. The government has considered their comments and others received over the last year, including those of the Audit Commission in its report "Capital Expenditure Controls in Local Government in England", which made a helpful contribution to the review when published in April 1985. The remainder of this chapter sets out the government's conclusions as a basis for further consultation.

6.12 Total gross capital expenditure by local authorities in a given year, their net capital expenditure after deducting receipts, and changes in their total indebtedness as measured by the LABR are all important to national economic management. Between a quarter and a third of all public sector capital expenditure is incurred by local authorities. The government's commitment to the firm control of public expenditure has been emphasised repeatedly, for example in the Green Paper on Public Expenditure and Taxation in the Next 10 Years (Cmnd 9189). There are two reasons why this is vitally important:

i. so that the PSBR can continue to fall as a share of the nation's gross domestic product (GDP). Lower money growth, and therefore lower inflation, will then be achieved with lower interest rates; and

ii. so that the role of the public sector can be reduced. This will facilitate the reduction of the national and local tax burden necessary to improve incentives and economic performance.

6.13 Lower inflation and interest rates make for faster growth of output and greater employment opportunities. A reduced tax burden as a share of GDP leaves a greater proportion of available resources to be allocated in response to market pressures, with benefits for efficiency which will also feed through into output and employment.

6.14 The government is therefore concerned with both borrowing and expenditure. A practical control system must however focus on one or the other. Economic arguments can be advanced for either; practicability will be an important determinant. Whichever approach is adopted, the new system needs to offer a much more effective degree of control than has previously been achieved if the interests of the national economy are to be well served. This will be of direct benefit to local authorities, because it will mean a more stable system in which they can plan ahead with confidence.

Views of the associations

6.15 The local authority associations have argued that it should be enough for the government to rely on constraints on revenue expenditure, without separate controls on capital expenditure or borrowing. Failing that, they maintain that if controls have to be retained, they should, as before 1981, be over new borrowing for capital purposes by service accounts from the CLF. In their view, the degree of control under such a system, which the government found inadequate before 1981, could be sufficiently improved by giving approvals on an annual basis, rather than allowing approvals to be exercised at any time. The associations have also argued for greater ease of capital planning by local authorities through further reductions in government control over the detail of local authority projects.

The government's comments

6.16 A large part of the complicated nexus of project controls which the government inherited in 1979 has already been swept away. The question of the scope for further simplification has not been considered in detail in the present review, because the need for controls is in any case under constant re-examination and further improvements are in hand. The coverage of housing project control was reduced in April 1985 so that for most categories of expenditure local authorities which are no longer in receipt of housing subsidy are exempt from submitting projects to the Department of the Environment for scrutiny. Plans are also being made to reduce control over education projects and projects involving the law and order services (police, probation and after-care, and magistrates courts) following reviews in the Department of Education and Science and the Home Office.

6.17 The government cannot, however, accept the argument that there is no need for control over capital expenditure or borrowing. At the very least borrowing controls are needed as part of the prudential regime which helps to safeguard the creditworthiness of local authorities. For more than half a century, local authority borrowing has been subject to a two-part system of control. Local authorities do not need specific consent to borrow temporarily pending the receipt of revenues, but there are strict limits on the amounts which may be borrowed for this purpose and all such loans must be repaid within three months of the end of the year in which they are taken out. All other borrowing, including therefore all long-term borrowing, requires government consent. These arrangements, which make it impossible for a local authority to build up a large revenue deficit and slide unwittingly into the problems which New York faced a few years ago, have been the foundation of the very high standing which local authorities have all consistently enjoyed in the financial markets. That standing must not be undermined.

6.18 Some form of effective control of borrowing or expenditure is also needed on economic grounds. Constraints on the revenue side are not enough on their own. Neither would such a control be adequately provided by a system based on the one which operated before 1981, even if it were modified into an annual control as envisaged by the associations. Local authorities would remain free, as at present, to replace temporary internal lending of surplus money by external loans at any time and to allow any degree of year-to-year fluctuation in the level of their short-term borrowing for revenue purposes. They would also be free to spend capital receipts at will. The very large bank of accumulated receipts would mean a real risk of a major surge in spending in the early years of the system. Even when that transitional problem was past, the level of the LABR would be liable to very considerable fluctuation from one year to the next, and this would militate against effective planning of the economy. Overall, influence over the LABR would be no greater than now and influence over spending would be less. This is no answer to the shortcomings of the present system.

Alternative approaches to borrowing control

6.19 Greater influence over the LABR would be achieved if it were possible to exercise control directly over external borrowing for capital by the CLF, since that is the point at which capital borrowing is measured for LABR purposes. The only element of the LABR outside control would then be fluctuations in revenue borrowing. But such a control would be impracticable. It would require local authorities to separate out revenue and capital completely in their day-to-day external borrowing. This would make for considerable inefficiency in the management of their finances.

6.20 Given that control of capital borrowing by service accounts would be inadequate for the government's economic purposes, and that control of external capital borrowing by the CLF would be inefficient, a broader approach would be needed if the future system was going to be based on control of borrowing alone without a direct capital expenditure control. The government has therefore looked closely at the possibility of introducing a control over all local authority borrowing, for both revenue and capital purposes, through a system of external borrowing limits (EBLs) broadly comparable with that used for nationalised industries. An EBL system, if operated successfully, could guarantee that a desired level of LABR would not be exceeded and exercise a very strong influence over levels of capital expenditure (though it would not give any direct control over capital expenditure financed other than by borrowing). It would also require authorities to finance any additional capital expenditure from revenue, where the cost would be directly perceived by the electorate: it would thus offer a high degree of local accountability.

6.21 There are two serious practical difficulties with EBLs to which a solution would have to be found. First, it would not be practicable to set a tailor-made EBL each year for every one of more than 450 local authorities in England and Wales. EBLs could be set on a formulaic basis, which might for example assume that all local authorities in a given class had the same need of external finance per head of population.

Alternatively, they could be set by reference to capital expenditure requirements, assuming that local authorities could operate their revenue cash-flow so as to avoid fluctuations in the level of their revenue borrowing between one year-end and the next.

6.22 But in practice individual local authorities' borrowing requirements for a given year bear little or no relation to the level of their capital expenditure, or to their borrowing requirement in other years, or to the borrowing requirement of other local authorities in the same class. These borrowing requirements, like the national LABR, are the difference between two large numbers, annual income and annual expenditure, and a small percentage fluctuation in annual expenditure leads to a much larger percentage fluctuation in borrowing. Cash-flow is the determinant of the borrowing requirement, not capital expenditure alone, still less class of authority. It is not clear, therefore, how to set satisfactory EBLs for each local authority.

6.23 Second, some form of safety valve would be needed, so that a local authority could increase its borrowing beyond its basic EBL to cover unforeseeable expenditure or an unexpected shortfall in income. There are various ways of providing such a safety valve, all of which build to a greater or lesser extent on the facility which exists in the present capital control system for one authority to transfer capital expenditure allocations and accompanying borrowing approval to another authority.

6.24 The simplest approach would be to allow an informal swap system to operate within an EBL system, or, which comes to the same thing, to allow local authorities to borrow from each other without effect on the borrowing authority's EBL. At the other extreme, a closed market might be established in cash or promissory notes in which only local authorities could deal and which would therefore not affect the LABR. There are various ways in which such a market might work. For instance, a local authority whose EBL proved inadequate might be allowed to sell promissory notes, using the proceeds to provide additional finance. The notes would be bought by local authorities with otherwise spare borrowing power. They would be redeemable in a stated future year, and would sell at a premium or a discount according to the state of the market.

6.25 The difficulty about any form of safety valve is that local authorities are likely to be cautious about concluding much in advance of the end of the year that they have spare borrowing power. There would probably be insufficient fluidity in the swapping or market arrangements. No such arrangements could compensate for insufficiently robust initial EBLs. It is not clear whether they would be adequate if the initial EBLs were sufficiently refined to cope with foreseeable fluctuations in borrowing requirements, leaving only the unexpected to be dealt with through a safety valve mechanism.

6.26 The local authority associations have indicated that they have particularly strong misgivings about the EBL approach and the government too has reservations. Expenditure control would not be complete, and it is not clear whether the practical problems could be overcome. Nevertheless, comments would be welcome on this approach as a radical new option which, if it could be made workable and effective, would relieve local government of much of the detailed control involved in the present system.

Expenditure control

6.27 At present it seems likely that a form of expenditure control which offered strong influence over borrowing and strong local accountability would prove a more promising alternative. Such a system would also need to satisfy the other objectives of the present system described earlier in this chapter, including the encouragement of asset sales and the achievement of stability. Greater stability for local authorities could be obtained with a system in which the national cash limits were set on gross expenditure, rather than by modifying the present net expenditure control, because the level of receipts in a given year would no longer affect the prospect of keeping total spending within the cash limit.

6.28 The Government has therefore concentrated on looking at ways of operating a control over gross expenditure. The key elements of such a system are considered in the rest of this chapter. A separate consultation paper is being issued on more detailed aspects.

6.29 Allocations: Each local authority would be given basic capital expenditure allocations each year as at present. In England, the separate components for the various service blocks are at present derived in a variety of ways: this may involve an individual assessment of an authority's expenditure needs, or a formula reflecting such factors as population or state of the housing or school building stock, or a mixture of the two. In Wales, a fairly simple formulaic approach is used for most allocations, but separate allocations are given for certain major projects such as highway works. No attempt has been made to standardise allocation procedures because of the differing characteristics of capital expenditure on different services. Under a new system there would continue to be scope for Ministers to make basic allocations in whatever way seemed most practicable in a particular case. It is envisaged that the scope for virement between services would be preserved in the new system. Authorities would also be allowed a degree of year-to-year tolerance on allocations, as now.

6.30 Capital receipts: A change in the treatment of capital receipts would be an essential feature of the new system. At present, there is no certainty at all as to how much local authorities in aggregate will choose to spend from their capital receipts each year. The theoretical maximum is very large, would be even larger if the proportion of such receipts available at local discretion had not been progressively reduced, and is growing every year. The growth is exacerbated by an error in the legislation which means that receipts may be spent in their entirety over time, instead of only a proportion of them; the proportion only constrains the rate of use in any one year.

6.31 The problem which the government faces in controlling expenditure in the face of such uncertainty is effectively transferred to local authorities through the continual prospect of rule changes. Local authorities also experience uncertainty of their own as to the precise timing of new receipts. In deciding how to tackle this problem, there is scope for a trade-off between achieving stability in the system and maintaining flexibility for individual local authorities.

6.32 If paramount importance were attached to stability, it would be essential for the level of available receipts to be known both to the government and to individual local authorities before the beginning of each year, and for the features of the present system which allow a steady build-up of receipts to be removed. At the same time, it would help if the level of receipts available for spending by an individual local authority did not fluctuate widely from year to year. The most promising way of meeting these points appears to be to allow each local authority each year to spend a proportion of the receipts generated by that authority in, say, the previous three years.

6.33 This would avoid the forecasting problem which applies to the immediate availability of new receipts, and because each year's receipts would influence three consecutive years' allocations, would damp year-to-year variations in spending power. This approach would also avoid the build-up of spending power from receipts: subject to any tolerance arrangements, receipts would be available to increase spending only in the three specified years: because of the interval between generation of a receipt and its availability for spending, local authorities should be able to plan to spend in full the permitted proportion of their receipts if they so wish. If it were felt necessary to preserve a means of catering for large projects outside the scope of the normal allocation process, for which local authorities have hitherto been able to save up receipts, it would be possible to incorporate a large projects pool in the arrangements for allocations. The logic of a gross capital control system is that individual local authorities' allocations should also be made on a gross basis. This would mean that the spending power from receipts would be included in allocations, rather than being available as an addition to allocations as at present. Allocations would consist of two elements: a needs element, determined individually or by formula as now, and a receipts element, calculated as described above.

6.34 As a transitional measure, during the first few years of the system, the receipts element in allocations would be based at least in part on the level of accumulated receipts brought forward from the present system.

6.35 An alternative approach would be closer to the present arrangement for receipts, and would preserve a greater degree of flexibility at individual local authority level. The legislative error, which is probably the single greatest problem with the present system, would be removed. Authorities would not be able to use capital receipts for extra spending in the year in which they arose, in order to remove unnecessary uncertainty: the total amount available for spending from receipts in a given year could be maintained by allowing the use of a higher proportion of the accumulated receipts. Apart from these changes, the existing rules would continue: the prescribed proportion of receipts would be available for spending as an addition to basic needs-based allocations in any year or years starting from the year after that in which the receipts were obtained. Transitional arrangements would be needed to enable local authorities to spend the whole of their existing cash receipts over time.

6.36 This approach would preserve flexibility but would expose local authorities to greater uncertainty and a greater risk of instability. The level of use which would be made of receipts would be much more difficult to forecast accurately than under the other approach, and it would be correspondingly more likely that the government would have to make adjustments, for example greater year-to-year fluctuations in the level of allocations, in order to keep the national total of gross expenditure within the cash limits. This approach might be more practicable in Wales, where the level of receipts has been proportionately lower than in England and the overspending at national level less marked.

6.37 Under either approach local authorities would have greater certainty in their capital planning if the proportion of receipts to be included in allocations, or allowed as an addition thereto, were fixed at the outset of the system; or alternatively if the proportion of gross provision to be made available in the form of receipts were so fixed. But this does not seem practicable. The proportion may need to be higher during the transitional period than thereafter, in order to take account of existing receipts. It may also be appropriate to change the proportion over time, or to differentiate between services, to reflect differences in the rate at which receipts are generated.

6.38 Comments are invited on the two approaches to the availability of receipts. Where reference has been made in this part of this chapter to the use of receipts, what is meant is their use to justify additional capital expenditure. No change is proposed in the present arrangement whereby the cash attaching to capital receipts may be used in full at any time to finance capital spending, for example in substitution for borrowing, or to redeem debt.

6.39 Revenue contributions: Local authorities have argued that the ability to decide to supplement capital expenditure from non-loan finance would introduce an important flexibility into any system. Such finance would include direct contributions from revenues received in the year, spending from special funds, and the use of various types of income which under the present system are deemed by regulations to be capital receipts, such as contributions from health and water authorities.

6.40 If such a facility were available, local authorities would no longer have to make a rigid distinction between revenue expenditure and capital expenditure financed from revenue which at the margin can often be artificial. In addition, the concept of "non-prescribed expenditure", that is capital expenditure scoring against the national cash limits but not against individual local authorities' spending ceilings, could be avoided; this would assist the control process. There would be an incentive to maximise revenue, through policy decisions such as rent increases and by more effective management. Accordingly, the government is prepared to consider providing in the new system for local authorities to supplement their allocations in this way to a limited extent.

6.41 The government would need to forecast and control this addition to local expenditure. To that end, each authority would be required to specify in its annual budget the extent to which it intended to supplement capital allocations from non-loan finance. That figure would be subject to an upper limit, perhaps a given percentage of a local authority's total revenue budget for the year. The figures selected by each local authority within that upper limit would then become the maximum amount by which the local authority could supplement its allocations in the year. If a local authority specified an amount for non-loan finance in their budget, this amount would become the minimum non-loan finance which would have to be applied to capital in the year. So if outturn capital expenditure fell short of the sum of allocations plus budgeted supplement, borrowing approval would have to be foregone. The revenue freedom would subsume the present freedom to use trading profits as additions to capital expenditure. Comments are invited on this proposal.

6.42 Borrowing approvals: For reasons outlined above, specific borrowing approvals would still be needed. Local authorities would be assumed to be able to finance expenditure justified by capital receipts from the cash attaching to the receipts, as now. Each local autority would receive approval for new borrowing for capital purposes by service accounts equal to the amount of its needs-based allocations, exercisable only in the year for which the allocations were given. The amount might be subject to marginal adjustments, as now, and would be reduced by any underuse of resources where a local authority opted for a degree of non-loan finance, as described above. The local authority would also still be allowed to borrow externally to replace internal loans. If the use of receipts was controlled as part of allocations, the extent to which local authorities might wish to undertake such replacement borrowing in any one year would be forecastable, and in practice this system would give a strong influence over net external borrowing for capital without the inefficiencies inherent in a direct control over that element of the LABR. If receipts continued to be available as an addition to allocations, there would be a greater element of uncertainty about levels of borrowing; this will have to be weighed in deciding whether or not to adopt such an approach.

Assessment of expenditure option

6.43 The government recognises the importance of stability in the efficient management of local capital programmes. There would be great benefits if, within the constraints of managing the national economy from year to year, it were possible to offer local authorities greater certainty about the amount of capital expenditure which they would be permitted to undertake, not only in the year immediately following but in years beyond that. Firm allocations can only be given on the conclusion of the annual public expenditure planning process, a few months before the year to which they relate. But firmer assurances should be possible than at present about the minimum level of allocations in years 2 and 3 because of the greater certainty of control inherent in the system. Coupled with the flexibility at the margin to add limited revenue contributions, this would offer much greater certainty in local capital planning than is possible under the present system.

6.44 Other elements of the system would bring further benefits at local authority level. Although receipts would not constitute additional spending power immediately, there would still be a strong incentive to generate them because they would do so in subsequent years. This would fit well with local authorities' natural preference, demonstrated under the present system, for securing their receipts before committing the spending of them. Above all, the greater effectiveness of the system at national level would mean fewer rule changes, and this more than anything else would mean greater stability and thus more efficient capital planning.

6.45 At national level, there would be a high degree of control over expenditure and thereby a stronger influence over the LABR than at present. There would still be no control over the considerable annual fluctuations in revenue borrowing. But such control could only be achieved through an EBL system, which is subject to the reservations noted above. For all these reasons, an expenditure control on the lines described above looks at this stage the most acceptable basis for a new system.

Conclusion

6.46 Comments are invited on the material in this chapter, and in particular on:

the relative merits of a system of EBLs and an expenditure control system;

the practicability of a system of EBLs for local authorities;

the expressed preference for an expenditure control system; and the details of the proposed system, including the two approaches to the treatment of capital receipts and the possibility of limited use of non-loan finance as an addition to allocations.

Comments are also invited on the separate consultation paper on capital.

6.47 Although no decisions have yet been taken on the timing of the change to a new system, comments on this chapter are needed to a shorter timescale than for the rest of the Green Paper so that early legislation can be sought if that seems desirable. Comments should be sent to ..... by ....