24/1/DJS/1801/8

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FROM: B H POTTER

DATE: 15 June 1988

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CHIEF SECRETARY

cc Sir P Middleton
Mr Anson
Mr Phillips
Mrs Case
Mr Edwards
Mr Turnbull
Mr MacAuslan
Miss Noble
Mr Richardson
Mr Saunders
Mr Wood
Mr Betenson
Mr Rea
Mr Call

17/6

POTTER TO CST 15 JUN

LOCAL AUTHORITY CAPITAL: DRAFT CONSULTATION PAPER

The Secretary of State for Environment's minute of 9 June to the Prime Minister covered a further revised draft of the consultation paper on the new local authority capital control regime.

2. The revised paper sets out substantially the same control scheme as the draft circulated by Mr Ridley on 15 March and discussed in my submission to you of 22 March. But two new proposals have been added following the further discussions at E(LF)(88)4th Meeting in April:

(i) that capital receipts from housing should also be covered by the new capital control regime; and

(ii) that there should be provision for local authorities to transfer some of their capital receipts to other local authorities or to health authorities.

3. You may recall that the latter idea came from the Prime Minister in the context of discussions on housing at E(LF). The Prime Minister has already responded to Mr Ridley's minute of

9 June and, while approving the consultation document in general, is seeking clarification of the proposals on transfers of spending power by local authorities.

Housing

4. It is now proposed that the capital control system should cover housing capital, both expenditure and receipts. But the proportion of housing capital receipts which local authorities will be able to spend has been set at 25% in the draft consultation paper, rather than 50% as for other local authority capital receipts. (The remaining proportion must be paid into each authority's proposed Capital Fund Account, to existinguish outstanding debt). 25% is a slightly lower figure than the 30% originally envisaged and discussed at official level. And any figure below about 35% is likely to provoke a hostile reaction from local authorities, particularly from the Association of District Councils. Our understanding is that DOE have put in a low figure with the idea of raising it in response to the inevitable outcry from the district councils during consultation. LG2 advise that there are no particular housing reasons for disputing the 25% proposal.

Redistribution of Surplus Receipts

5. Following the E(LF) meeting referred to earlier, Mr Ridley was asked to consider how capital receipts might be transferred to other authorities in particular from districts to counties. The scheme described in paragraph 30 of the draft would involve those local authorities with no outstanding debt remaining and hence "surplus" receipts being able to lend some of these receipts to other authorities within the same geographical area. But the outline scheme poses at least three problems.

6. First, No.10 are unhappy with the proposals. The DOE approach would confine the scheme to authorities with surplus receipts. In the short-term very few authorities will be in such a position - though their number will grow, particularly if large scale housing disposals take place. The Prime Minister seems

to have had in mind a much more ambitious arrangement (though this is not reflected in the E(LF) minutes). This would allow local authorities to transfer not only capital receipts but also their other main source of spending power - their credit approvals (ie borrowing permissions from central government) - to other authorities

7. We are not attracted to a general scheme for transferring spending power from one authority to another, ie capital receipts and credit approvals. No local authority will voluntarily transfer its own credit approvals - a one-year borrowing provision from central government - to another authority. Giving financial incentives to encourage them to do so would be perverse and inefficient and risk adding to total LA capital expenditure. Why allow credit approvals, based on central government's assessment of each LA's needs, to be transferred? We agree with DOE that any scheme should be confined to transfers of capital receipts. We also agree that it should apply only to authorities with 'surplus' receipts. It must remain the case, as Ministers decided last year, that the first claim on all capital receipts should be the extinction of outstanding debt. Authorities should not be permitted to lend receipts while they still have outstanding debt (making a profit in doing so).

8. Secondly, we need to be sure that a narrower scheme for authorities with surplus receipts does not lead to higher expenditure overall. In order to make the scheme attractive there would have to be incentives on LAs to participate; and that inevitably would lead to pressures for such spending to be additional. The present draft of paragraph 30 hints at all this but in a rather obscure way: it will need to be revised to refer to <u>local</u> additionality (so that we have scope to net off forecast use of the arrangement in determining credit approvals at the national level). This clarification of the consultation paper will no doubt put the local authorities off the idea. Neither we nor DOE officials would be particularly unhappy at that prospect.

9. Finally, again in line with the conclusions at the E(LF) discussion, the revised draft proposes that 'surplus' capital

receipts might also be transferred to health authorities. Currently health authorities have no borrowing powers. Although Mr Ridley is considering whether a transfer of a grant rather than a loan might be allowed, this would still set an unwelcome precedent. The present imbalance in health authorities' income and expenditure accounts is in part due to the current expenditure consequences of the capital programme. One of our objectives in the Survey will be to get this engine of growth under better control. Giving health authorities access to additional funds for capital projects would frustrate this and be likely to generate current expenditure requirements which may not be sustainable from income available.

10. Any extra money from local authorities should therefore be offset by a reduction in the voted expenditure for capital. But this could lead to a distortion of priorities in the HCHS capital programme. Projects financed by receipts transferred from local authorities could be going ahead at the expense of better schemes which would have been fired from the HCHS capital vote. Similarly those regions where the local authorities had surplus receipts to transfer would stand to do better than others. Mr Ridley's proposal is therefore not something we would wish to pursue.

Conclusion

11. Mr Ridley is right to emphasise in his covering minute the importance of getting a draft consultation paper agreed quickly and circulated. But I think the difference of views between No.10 on the one hand and DOE and ourselves on the other about the scope of the scheme for transferring spending power needs to be resolved. Moreover No.10 Policy Unit has hinted - without any commitment of course - that the Prime Minister might be persuaded to narrow the scope of the scheme to authorities with surplus receipts.

12. I therefore recommend that you write to Mr Ridley endorsing the broad shape of the capital control regime; accepting his proposals on the treatment of housing capital receipts; supporting

his view that the scheme for transferring spending power should be narrowed to authorities with surplus receipts (and refer to local additionality as being the incentive); and rejecting the idea that the scheme might extend to health authorities.

13. This advice has been agreed with GEP, LG2 and ST. I attach a draft letter for you to send to Mr Ridley.

Barry H. Potter

BARRY H POTTER

24/1/DJS/1801/9

CONFIDENTIAL

Pl. type

DRAFT LETTER TO THE SECRETARY OF STATE FOR THE ENVIRONMENT

LOCAL AUTHORITY CAPITAL CONTROL REGIME

Thank you for copying to me your minute of 9 June to the Prime Minister covering a revised draft of the consultation paper on the control of local authority capital expenditure. I have also seen a copy of the letter of 13 June from the Prime Minister's Private Secretary to yours.

I appreciate that the consultation paper needs to be issued as soon as possible and I remain content with the broad capital control regime proposed. I also agree that the new scheme should apply to housing and I am content that the proportion of housing receipts which local authorities will be allowed to spend on capital projects should be set at 25% in the consultation document.

I share however the Prime Minister's concern about the drafting of paragraphs 22 and 30 in the consultation document which describe the proposals to transfer spending power from one local authority to another. We have of course not discussed this further at Ministerial level since the E(LF) meeting in April. But my own view is that any such scheme should be confined to transferring capital receipts and only those local authorities with surplus receipts should be eligible. For other authorities still in debt, the first call on any capital receipts should be the extinction of outstanding debt. I do not see a case for any easing of the requirement to repay debt from the proceeds of assets built with public money, until all such outstanding debt is relinquished.

However I would be prepared to go along with a more limited scheme which applied to those local authorities with surplus receipts, providing there are no implications for total local authority capital expenditure. I think the draft in paragraph 30 would therefore need to make clear that the incentive on local authorities to participate in such schemes would involve some element of local additionality. Any such scheme could not be allowed to add to aggregate capital spending by local authorities and would therefore need to be taken into account in determining credit approvals at the national level.

Finally I am particularly concerned at your proposal for the scheme to allow surplus receipts to be transferred to health authorities for capital projects. The additional capital spend would inevitably generate current expenditure requirements which might not be sustainable from the income available to ~~local~~ health authorities. To avoid such problems arising I consider that any transfers from local authorities would have to be offset by a reduction in the voted allocation for capital expenditure. However, this in turn could lead to a distortion of priorities in the NHS capital programme. Overall therefore I think it would be better if health authorities were not included in such a scheme.

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I am copying this minute to the Prime Minister, the other members of E(LF) and to Sir Robin Butler.

[J.M]

pnp

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

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This does all put a rather different complexion on things. Difficult to know which way to go ~~[illegible]~~ until further advice from officials received.

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