

PERSONAL AND CONFIDENTIAL



CC:
 PS/Chancellor
 Mr Anson
 Mr Phillips
 Mr Edwards
 Mr Potter
 Mr Fellgett

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
 SW1P 3EB

Handwritten initials 'np' circled in a hand-drawn oval.

22 June 1988

Handwritten signature 'Dick' with a flourish.

LOCAL AUTHORITY CAPITAL: CONSULTATION DOCUMENT

Following discussions on the RSG settlement for 1989-90 earlier this week, officials have brought to my attention the risk of a surge in local authority capital expenditure between next week, when the capital consultation document is to be issued, and the introduction of the new control regime in 1990. Even though I understand the consultation paper is already at the printers, we need to meet urgently to discuss whether this risk can be reduced satisfactorily or eliminated by changes to the transitional proposals. I should emphasise that the changes I have in mind would be to details of the transitional arrangements before 1990, not our substantive proposals on how the new regime should work. I am well aware of the difficulties any further delay in publishing the consultation document will cause; but the sums at risk are so large, that if changes are found to be necessary, we must be ready to hold up publication for a few days.

The problem is the existence of some £7 billion in cash-backed capital receipts, mostly in the form of money on deposit. Around £5 billion is held by the Shire Districts. Under the proposals in the capital consultation document, 75 per cent of cash-backed housing receipts and 50 per cent of other cash-backed receipts held on 31 March 1990 must be used to redeem outstanding capital debt or set aside to meet future capital commitments. Local councils will therefore have an incentive to use cash-backed receipts before 31 March 1990, while they are available to be spent, rather than after that date, when more than half of them must be used to redeem outstanding debt.

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Of course, our present controls on the proportion of capital receipts which can be used to finance prescribed expenditure should help to prevent excessive prescribed spending. But there are no such controls over non-prescribed spending - the bulk of which comprises capitalised current expenditure on repairs and maintenance. So we will be at risk of cash-backed receipts being used on a major scale to finance such repairs and maintenance between next week and 1990. Your own officials have estimated that up to about £1 billion of cash-backed receipts might be used this way; and up to a further £700 million used to substitute capital receipts for due debt repayments rather than meeting these out of revenue account.

Moreover the incentives to use capital receipts in these ways are considerably enhanced by the present RSG system. Capitalising current expenditure allows local councils to reduce their recorded total expenditure and increase their entitlement to block grant. Indeed there has always been an incentive in grant terms to capitalise current spending: but that incentive will also disappear from 1 April 1990, with the introduction of the new Community Charge regime.

So, from the date the consultation document is issued, local councils will have an incentive to use outstanding cash-backed receipts over the next eighteen months rather than see more than half of that spending power lost after 1 April 1990. They will have the opportunity to use, in principle all though in practice considerably less, of the receipts to finance capitalised current spending which scores as non-prescribed (uncontrolled) capital expenditure. And to the extent they do use them in this way they will have the added financial benefit of extra block grant payments.

We must be at serious risk of a surge in expenditure. Difficult though any delay would be at this stage, my officials consider that the detailed transitional proposals in the consultation paper must be revised so as to prevent or at least strongly discourage local councils from excessive drawing down of the money held on deposit from cash-backed receipts. I suggest our officials meet urgently to consider how this could best be done.

In view of the possible implications for the publication date of the capital consultation paper, I am copying this letter to the Prime Minister.

Yours Ever,
John Major

JOHN MAJOR