

CHIEF SECRETARY

FROM: B H POTTER

Date: 2 February 1989

cc: **PS/Chancellor**
 Sir Peter Middleton
 Mr Anson
 Mr Monck
 Mr Phillips
 Mrs Case
 Mr Edwards
 Mrs Lomax
 Miss Peirson
 Mr MacAuslan
 Mrs Butler
 Mr A White
 Mr Wood
 Mr Laite

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 [Signature]

Ch/ For info. @15

Handwritten notes:
 a
 No need to wade through all this.
 Paras 1-11 are a useful description of new system
 Para 41 is worrying but unsurprising
 Paras 52-56 indicate major rows in project with
 Depts & LAs.

LOCAL AUTHORITY CAPITAL EXPENDITURE: 1989 SURVEY

I attach a submission on the conduct of the 1989 Survey for local authority capital expenditure. I apologise for its inordinate length. But it is designed to set out in detail how local authority capital will be handled in the negotiations with Departmental Ministers in the 1989 Survey.

2. You may find a brief guide helpful. Section A describes the background to the new capital finance regime and the new planning total. You may wish to take that as read and focus instead on section B. It is this section which describes the Survey arrangements envisaged for 1989. Section C on setting the baseline is essentially covered in the draft letter to the Environment Secretary and can therefore perhaps be skimmed through. Section D is important however: this describes the main proposals for handling the first steps.

3. I imagine you will wish to discuss this submission with us.

Handwritten signature: Barry H. Potter

BARRY H POTTER

CONFIDENTIAL

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LOCAL AUTHORITY CAPITAL EXPENDITURE: CONDUCT OF 1989 SURVEY

This submission (agreed with GE) puts forward proposals for handling the 1989 Survey for local authority (LA) capital expenditure in England and setting the baselines. I fear the subject is very difficult but important: you will probably wish to talk it through with LG and GEP (and possibly HE and ST also).

2. By way of background, Section A first describes the post 1990 capital finance regime for LAs; explains the proposed treatment of LA capital spending within the new planning total (NPT); and draws attention to what the various interested parties - Treasury, spending Departments and LAs - will be looking for from the revised public expenditure planning arrangements.

3. Section B then considers how the various steps in the 1989 Survey on LA capital can best be organised - baseline, bidding process and negotiations - and what supporting information is needed to ensure a fair and orderly Survey.

4. Section C puts forward specific proposals on the first of these steps - setting a baseline. Finally Section D describes a number of handling issues and provides a draft letter for you to send to the Environment Secretary, setting out proposals on the conduct of the Survey.

SECTION A: THE NEW CAPITAL FINANCE REGIME AND THE NEW PLANNING TOTAL

New Capital Finance Regime

5. From 1 April 1990, a new capital finance regime for the main LA services (education, housing, transport, personal social services and other services) will be introduced in England and Wales.

6. The present capital control regime seeks to control total LA capital expenditure directly. The new regime focuses on the sources of finance for capital spending as follows.

(A) CENTRAL GOVERNMENT

(i) Credit Approvals (CAs): central government permissions for an individual LA to borrow or raise other credit.

(ii) Government grants: capital grants from central government and from the EC to finance capital spending.

(B) LAs OWN SOURCES OF FINANCE:

(i) Revenue contributions (RCCOs): LAs may pay for capital spending from revenue contributions; although rccos will not be controlled they will be subject to the accountability of the Community Charge.

(ii) Capital receipts: local authorities will be required to set aside 25% of their Housing receipts and 50% of other capital receipts from asset sales for debt redemption. The remaining balance will be available to finance new capital spending.

7. In each year each LA will receive a share of the available central government resources under (A) - the permissions to borrow (CAs) and capital grants. But, subject to the general restrictions noted above, each LA will be able to spend whatever it judges appropriate using the supplementary sources of finance in (B).

8. An objective of the new proposals is that the share of central government resources made available, in the form of credit approvals for each LA (Ai) should be more closely matched to the individual authority's financial as well as its real needs. For this reason the availability of receipts to finance the LAs capital programme will be taken into account (RTIA)* when distributing the CAs. The mechanism adopted is that a percentage of the capital receipts available to be spent will be added to the CAs total to form an Annual Capital Guideline (ACG). For each service block (ie education; housing etc), it is the ACG which will be distributed according to a central government generalised needs index (ie real needs) to the authority.†

9. It is the CA that conveys permission to borrow. ACGs and RTIAs are essentially accounting devices to arrive at an appropriate level of CAs for each authority, given its access to accumulated receipts. ACGs also provide an indicator of the Government's view of each LA's relative needs as between services.

†This of course contrasts with the present system for distributing capital allocations: by service these are allocated to each LA according to real needs, with no account being taken of the different access to spending power available from receipts.

* Receipts Taken Into Account

10. Each LA will therefore receive its share of the central government resources through an ACG for whatever service blocks are relevant. Deducted from its total ACG will be its own receipts to be taken into account (RTIA), leaving a block (ie unhypothecated by service) credit approval. An example might be for a typical English district.

		£m
ACG for Housing	=	3
ACG for Other Services	=	<u>2</u>
		5
RTIA		<u>1</u>
Block Credit Approval		<u>4</u>

New Planning Total

11. Under the new planning total, only those elements of public expenditure within the responsibility of central government are included within the NPT. In the case of local authority capital expenditure, that is those in category (A) ie credit approvals (Ai) and central government (and EC) grants (Aii). LA capital expenditure financed from own sources of finance (B) will not be in the NPT, but will be within general government expenditure (GGE). (Changes to the planning total have no impact on GGE which continues to include all LA expenditure.) These own sources of finance are whatever spending LAs in aggregate choose to finance from extant capital receipts (Bi) (once the required percentage has been set aside for debt redemption) and any revenue contributions to capital outlays (Bii).

12. At the outset, it may be helpful to highlight certain features of the combined effect of the new capital finance regime and the introduction of the NPT which are particularly important for future public expenditure planning on local authority capital.

- i) In future, there will be no accepted measure of the absolute need for capital spending. At present, gross provision (which included all sources of spending on LA capital) could be said to represent the level of the total need to spend on each main service accepted by the Government in any year.
- ii) It will, however, be necessary to project likely LA capital spending financed from own resources (B) in order to derive a forecast of GGE. This projection when added to (A) the central government resources provided for spending on LA capital, will enable a forecast of total LA capital expenditure to be made.
- iii) The Annual Capital Guideline (ACG) for each service will be a measure of the Government's assessment of relative needs as between service blocks - not absolute needs. In 1990-91 it will cover only about 60% of likely total spending: spending from capital grants, rccos and from receipts not taken into account will make up the remainder; and the allocation of this spending amongst services will be a matter for LAs. So it will not be possible to arrive at an accurate forecast of total spending by service block.
- iv) The ACGs are important in two respects. First, for the individual LA level, they determine its share of central government resources. Moreover each LA may feel obliged to spend up to the ACG on each service (as they do at present with capital allocations): the ACG would thus form a floor on its service spending. Second ACGs are likely to be important to an individual Department. Even though they cover only around 60% of total spending, they represent a floor on total service spending; and aggregate ACGs will reflect Government priorities as between services over the resources they direct.

- v) ACGs however are not meaningful at the total level across all services. They do not represent total needs or total central government resources or total spending.
- vi) Local authorities will receive an unhypothecated block credit approval. It will be up to them to determine how it should be spent as between services. This might bear little resemblance when aggregated across all LAs either to the service distribution of ACGs or to the CAs by service.

13. It is also instructive to consider what concepts the main parties will be focussing on in the public expenditure planning process.

14. For the Treasury, most important will be the total CAs (and to a lesser extent the distribution) and provision for capital grants, particularly for 1990-91, but also for the two forward years. The Treasury will also be interested in the forecast of total LA capital spending which will be part of GGE.

15. For individual service Departments, attention is likely to focus on the ACGs by service (and capital grants to a lesser extent). They will regard figures for the CAs by service mainly as an input into the ACGs. As always, interest will mainly be on the first year: but they will also wish to seek high provision for the forward years. Moreover Departments are well aware that the ACGs cover only about 60% of likely total LA spending. In presenting the outcome of the Survey, they will also wish to give some indication of the likely total capital spending on their particular service, at least for the year ahead.

16. For the individual local authority, the ACG as a service planning indicator will be relevant; but in practice, it will be less important than the block credit approval - the amount of new borrowing permitted by central government. Local councils will want some indication of the resources available to them in the two forward years for capital programme planning purposes. Such an undertaking was given in the consultation document.

SECTION B: THE SURVEY PROCESS

17. Against that background, and in particular what the main parties will be looking for from the revised public expenditure planning process, the Survey arrangements must enable decisions on the following for 1990-91:

- CAs and capital grants by service block (and by department) since these are components of the NPT and must be reported to Parliament;
- RTIAs, so that the ACGs by service block can be determined;
- ACGs, so that block credit approvals can be issued to each local authority.

For the two forward years, at a minimum it will be necessary to establish provision for CAs and capital grants. Finally, in order to project total GGE, it will also be necessary to forecast likely spending on LA capital for all three forward years.

18. The remainder of this section considers how efficient Survey arrangements can best be put in place to meet the above requirements.

Objectives

19. A number of objectives for an efficient 1989 Survey can be identified. First there must be a stable and orderly framework within which Departmental Ministers can negotiate with Treasury Ministers over the central government resources for LA capital expenditure ie credit approvals and capital grants. That requires an agreed and well-understood framework for the Survey steps - fixing of baselines; the invitation of bids; how bids are to be prepared; the timing and content of the negotiations; and the arrangements for the presentation of the Survey outcome.

20. Secondly the negotiating framework must be consistent with the constraints of the normal Survey timetable. Thirdly, in the transitional Survey, it will be necessary to avoid setting any unfortunate precedents for the conduct of future Surveys.

Survey framework

21. Discussions with departmental officials have agreed the basic negotiation framework. It would be sensible to retain the present bilateral mode, with Departmental Ministers negotiating separately for the central government resources in terms of credit approvals and capital grants for their individual services. (At a later stage it may be desirable to reorganise the service blocks but for the remainder of this submission it is assumed that the existing five blocks will be retained.) It is the decision on credit approvals for each service block which will form the base for the Annual Capital Guidelines that each Department will issue to the relevant local authorities. Thus there will have to be separate baselines for each service block; separate bids; and separate bilateral negotiations.

22. You wrote on 13 January proposing that at least for the transitional Survey, credit approvals should be the main "currency" of the negotiations (alongside capital grants). They are preferable to using ACGs because CAs are the borrowing measure referred to in the proposed legislation; they are simple and broadly comparable to the existing Survey currency of capital allocations; they will feature directly in the new planning total; and they will influence the LABR directly. The Transport, Home and Education Secretaries have now written accepting this for the 1989 Survey.

23. Your letter also included a timetable for the Survey which has also been accepted: the main steps are as follows:

TIMETABLE FOR LA CAPITAL

Baselines	February	i)	set baselines for capital grants and credit approvals for 1990-91 and 1991-92 on provisional assumption about receipts;
		ii)	set a provisional assumption about RTIA for 1990-91;
	April	iii)	finalise baselines in the light of latest data on receipts;
		iv)	create baseline for 1992-93;
Bidding	May	v)	invitation to Departments to put forward proposals for variations to CAs and capital grants in baselines;
	June	vi)	Departmental letters submitted;
	July	vii)	RTIA by department for 1990-91 fixed;
Bilaterals	September/ October	viii)	bilateral negotiations on CAs and capital grants for all three years;
		ix)	ACGs for 1990-91 formed by adding CAs to RTIA for each service block.

Each step is considered below.

Setting baselines (i)-(iv)

24. Following discussions at official level, we are sufficiently close to agreement for you to put forward proposals for setting baselines for CAs and capital grants for 1990-91 and the two forward years and an RTIA figure for 1990-91 only (items (i) and (ii) above). This is covered in Section C of this submission. The baselines will be finalised in April (iii) and (iv).

Bidding Process (v)-(vi)

25. Once the final baselines are established in April, Departments will begin preparing their bids. Given their interest mainly in ACGs and in total likely spending on their service, they are likely to seek supporting information going beyond the items scored directly in NPT, to inform the bidding process.

26. Discussions at official level have convinced us that a forecast of gross LA capital expenditure must continue to play a part not just in informing bids but also facilitating resolution at the bilaterals and smoothing the presentation of the outcome. In content, the figure would be the same as gross provision for LA capital; in status, it would be quite different - a forecast and not a plan.

27. It is proposed that the figures for gross provision for 1990-91 will be updated to form a forecast of gross LA capital expenditure and be made available before the bidding process. Departments earlier expressed concern that they should be aware of what a particular level of CAs implied for ACGs throughout the Survey. These proposals now go further: Departments would also have a broad view of likely total gross spending. They would know whether baselines CAs and capital grants would be consistent with higher or lower capital expenditure than the gross provision in

the 1989 PEWP. In essence, this allows Treasury and Departments to negotiate on the resources which Government does control with an up to date picture in mind on what is happening to LA capital spending they do not control ie that financed from LAs own resources.

28. These revised forecasts on likely spending on gross LA capital will have to be circulated no later than end-April in order to influence the bidding process. (It should be emphasised that it would not change the baseline CAs figure.) It is an unfortunate accident of timing that further information on spending from receipts will become available first in late June and then again just as the bilaterals begin. It would not in practice be possible to ignore this information; and clearly such changes in economic circumstances would be relevant to the bilateral negotiations. So it is proposed that DOE and Treasury officials should meet before the bilaterals and provide for Departments a final revised assumption about the total use of spending power from receipts and rccos and hence forecast LA capital spending for each of the three Survey years to assist the bilateral negotiations.

29. On the basis of the baseline figures circulated earlier, and informed by the latest data on forecast gross LA capital expenditure, Departments will be invited to put forward proposals for variations from the baseline in late May.

Fixing the RTIA (vii)

30. It is highly desirable that the receipts taken into account (RTIA) by service should be fixed in advance of the bilaterals. Ideally this would be done before the bidding letters were invited: but because of constraints on data availability, it is not possible to settle the figure until mid-July. (RTIAs refer to

accumulated receipts as at end of the previous financial year ie 1988-89 for this year's Survey: the figure is thus not affected by revised forecasts of in-year receipts declared in the Survey.) Once the RTIA is fixed for each service block, any changes to the baseline CAs agreed in the bilaterals add £1 for £1 to ACGs. This should help ensure an orderly Survey.

Bilaterals (viii)-(ix)

31. At the bilaterals, Departments will negotiate on credit approvals for 1990-91 (and by extension ACGs), credit approvals for the two later years and capital grants for all three years. The negotiations will be informed by the latest information on likely spending below the line as already noted. One issue which will concern departments is whether there should also be decisions on ACGs for years two and three. This is covered in Section D.

Presentation of the Survey outcome

32. From the Survey will emerge:

- i) provision by service block for capital grants) for 3
 - ii) provision by service for credit approvals) forward
-) years

33. In addition, the following information will then be derived:

- a) by linking together CAs and the previously agreed RTIA, it will be possible to establish ACGs for each block for 1990-91;
- b) by linking together the latest forecasts of receipts and use of rccos, and the decision on local authority capital items above the line, a forecast of total LA capital expenditure will emerge; (this could be adjusted to reflect the emergence of later information right up to the publication of the Autumn Statement);

- c) this forecast of total LA capital expenditure could be broken down by service on stylized assumptions to give an indication of forecast spending by service for 1990-91 (it would not be sensible to project spending by service on this basis for years 2 and 3). Thus Departments would be able to say at the conclusion of the Survey that, if local authorities spent their receipts in the same pattern by service as in the latest year for which outturn information is available, the provision of CAs and grants would be consistent with a forecast expenditure on the service of £X million.

34. In the Autumn Statement itself, total provision for credit approvals and capital grants will be shown in the tables; the forecast for total LA capital expenditure will be identified separately. Departmental CAs and capital grants will be components of the Departmental tables showing total programme expenditure but will not be separately identified except possibly in the text.

35. Departments may wish to show ACGs and capital grants in their Departmental Press Notices and may choose - on the stylized assumptions agreed - to publish the forecast of total capital expenditure for the year ahead as well as the CAs.

36. In the White Paper to be published in January, Departmental tables will show credit approvals and capital grants; ACGs and perhaps the stylized forecast of gross capital expenditure would be referred to in the text (if at all).

SECTION C: SETTING THE BASELINESTotal Credit Approvals

37. An official group has been meeting for several weeks to discuss setting the provisional baseline for CAs and capital grants for 1990-91. The basic method is relatively straightforward: starting with gross provision for 1990-91 as determined in last year's Survey, what room is left for credit approvals after other likely spending from other sources of finance has been subtracted?

38. Table 1 shows the basic steps in the calculation. Most of the lines in the table are uncontroversial: but there has been considerable difficulty in reaching agreement on lines 3 and 4 - the likely spending from available capital receipts. That is estimated from total forecast available receipts (not a disputed figure) multiplied by an assumption about the likely extent (in terms of a percentage figure) to which they will be used. It is this assumption which has proved difficult to agree.

39. For the last four years under the present capital control regime, the percentage of available spending power from receipts likely to be spent has been set at around 50%. For 1989-90, it was assumed to be 53% when gross provision was set - but may well turn out to be rather higher at 60% or above. In 1990-91, with the introduction of the new financial regime the stock of capital receipts which can be spent will fall by around one-third from an estimated £4.6b to £3.2b. The flow of new capital receipts which can be spent will be reduced to one-quarter (housing) and one-half (non-housing) of the previous rate - for any given level of receipts.

40. Against this background, DOE officials proposed that the assumption for 1990-91 should be that only 40% of receipts available for spending would be spent. They pointed out that the introduction of new capital regimes had in the past sharply cut back spending. Treasury officials initially argued for 50% -

making the line that the level of spending would fall in proportion to the reduction in the stock. But this took no account of the uncertainty effect or reduced inflows and we now favour an assumption of 45%. All other departmental officials would reluctantly accept 45% but DOE officials (who had at one point accepted an assumption equivalent to 43%) reserved their Ministers' position.

41. On an assumption that LAs will choose to spend only 45% of the capital receipts available, the room for credit approval should be £2,353m. This may seem high relative to the figure of £1918m for baseline capital allocations for 1989-90. But the figures are not directly comparable because of the changes in the capital control regime (see table 2): both are however consistent with the relevant gross provision. What is clear and worrying is that in 1990-91 and for the next few years thereafter, there will be considerable uncertainty about LA capital spending financed from their capital receipts. There must be a risk of an overshoot (or undershoot) of GGE targets because of this.

Distribution of CAs by service

42. Officials have reached agreement that the best way of distributing the baseline CAs is to undertake the calculation described in table 1 for each service block separately, starting with the gross provision by block agreed in the last Survey. The provisional baselines for CAs for each service which emerge are set out in table 3.

RTIA

43. The relevant receipts to be taken into account are the accumulated receipts as at March 1988 - the latest certified figure for receipts available. The main issue on RTIAs is the percentage of these to be taken into account. Two policy objectives need to be balanced. The higher the percentage, the less the incentive on LAs to realise asset sales. (This is because the higher the level of receipts taken into account for an individual authority the less will be its share of the available

CAs.) On the other hand, a high percentage of receipts taken into account means that there will be a greater ability to match credit approvals to real and financial needs. The particular advantage to the Treasury is that we can argue for a smaller total amount of CAs to meet any given level of real needs.

44. On balance, Departments at official level are prepared to support a figure of 25%, giving a total RTIA of £475m. Because only around 45% of receipts are likely to be spent, this means that very nearly half of the likely spending from accumulated receipts as at March 1988 will be taken into account through the RTIA in distributing CAs.

Distribution of RTIAs

45. This sum has to be distributed amongst the service blocks. The conclusion at official level was that, since these receipts are effectively a mechanism for directing ACGs towards a particular service block their distribution should reflect the relative service priorities held by central government. For 1990-91, the best available indicator of that is the gross provision. It is therefore proposed that the RTIAs be distributed in proportion to gross provision. (This is a rationalisation of the outcome of lengthy horse-trading which is satisfactory to us and most Departments.)

46. The outcome in terms of CAs, RTIAs and hence ACGs is shown at table 3.

Forward years

47. Finally, it is proposed that baseline CAs and capital grants for 1991-92 and - in due course - 1992-93 should be formed by applying an uplift factor to the baselines for 1990-91. The alternative of trying to set CAs consistent with 1991-92 gross provision would be technically possible but difficult and open to prolonged dispute. (Our calculations also indicate it is likely to be less favourable from a Treasury viewpoint.)

48. It is proposed to apply a 2½% uplift factor to form the 1991 92 baselines, (as proposed for grants on the current side) -see table 4. DOE will be looking for a higher figure to reflect their expectation of falling spending from capital receipts. But Mr Ridley may be reluctant to press the point at this stage, instead leaving the argument for the bilaterals.

49. It will be necessary to construct a baseline for year 3 (1992-93). The usual procedure is that a common uplift factor is applied to all items in the planning total. It is proposed that the baseline for CAs and capital grants in 1992-93 would be treated in the same way. On the normal timetable, Treasury would circulate the amended baseline by end-May.

SECTION D: HANDLING

50. Colleagues have already accepted credit approvals as the currency for the Survey and agreed to the outline timetable in your letter of 13 January. At official level, the proposals on the provisional baseline for 1990-91 discussed in the preceding section, have already obtained near-agreement - with only DOE officials reserving their Minister's position. You are also in a position to put forward proposals for the 1991-92 baseline.

51. I recommended that you now write to Mr Ridley setting out these proposals and seeking formal agreement to the provisional baselines. It would also be appropriate to describe the role now envisaged for the RTIA and the forecast of total capital expenditure in the letter - again Departmental officials are likely to welcome these.

ACGs for Future Years

52. But there is one important issue still unresolved. As described earlier, the Survey will settle provision for 1991-92 and 1992-93 in terms of credit approvals and capital grants. But as noted in paragraph 14, both Departments and individual IAs will be expecting ACGs to be determined and announced for the two forward years. The Treasury view is that it would not be safe to give such commitments in terms of ACGs.

53. We have considered carefully what information might be given to local authorities about the room for capital spending in future years. In the consultation paper, it was proposed that notice of ACGs for years 2 and 3 equal to 85% of the provision for year 2 and 70% of the provision for year 3 should be given to individual authorities. That presents serious problems.

54. Ministers will be deciding only on CAs by service for years 2 and 3 in the Survey, not ACGs. It would only be possible to project ACGs if an assumption were also to be made about RTIAs. That in turn would require assumptions to be made about available

receipts, even though spending from receipts is unclear; and, under the philosophy of the new capital finance regime, such expenditure is for LAs not central government to determine. Moreover were that projection inaccurate because LAs ran out of capital receipts more rapidly, the ACG figure could only be maintained with unchanged CAs by increasing the RTIA percentage. That would be perverse (as receipts were running out, the Government would be reducing the incentive to realise receipts). In short, if the Treasury were committed to an ACG figure for say 1991-92 and the RTIA figure fell, we would have effectively conceded more CAs in the baseline than agreed by Ministers in the previous Survey. That is clearly unacceptable.

55. Nor does a forward indication in terms of ACGs work satisfactorily at the level of an individual LA. Imagine a commitment to a £5m ACG for 1991-92, based on £4m in CAs and an RTIA of £1m. In 1990-91, the LA could spend all available receipts (ie including the £1m RTIA): the Government would be forced to give it even more spending power, with £5m rather than £4m in CAs for 1991-92. This would be a very perverse incentive.

56. Nor is a figure for ACGs meaningful to an individual authority given an ability for the Government to change the RTIA percentage. The Treasury believe it would be more helpful to an individual LA if the undertaking were framed in terms of its block CAs ie that the block CAs would not be less than X% of the previous year's figures. This would give LAs a real indication of the resources available to them. The percentage numbers will need to be agreed: but they are likely to be lower than the 85% and 70% percentages previously in mind for ACGs. To safeguard the proposal from abuse, a let-out clause will be necessary so that in the event of a major receipt from a large sale (eg the entire council house stock) the CA figure for an individual LA could be cut further ie the commitment would be framed in terms of X% of CAs, provided receipts did not grow by Y%. (Y will have to be reasonably generous to avoid any disincentive to asset sales.)

X/ 57. The logic of this is that Ministers will therefore not need to decide ACGs or RTIAs for the two forward years. That is necessary to reduce the exposure of the Treasury. But several Departments will be very unhappy at the prospect - particularly those which regard ACGs as the indicator of needs. Moreover the wording of the consultation document is (with hindsight) regrettably unequivocal in the technical section in terms of the commitment to a future indicator of ACGs: fortunately, the commitment in the main document is framed in terms of credit approvals (see attachment A).

58. Several Departments are likely to regard any 'backsliding' on this commitment to ACGs as an explosive issue likely to antagonise the local authority associations - even though, for the reasons explained above, it may be possible to put in its place a more meaningful commitment to CAs for the individual LA. That said however LG and GE consider it tactically better to get agreement on the rest of the Survey proposals and baselines first - though you will need to flag up future commitments as an issue for further consideration.

59. But the tactics are a matter for your judgement. I attach a draft letter for you to send to Mr Ridley.

BHP

BARRY H POTTER

bas1
2/2/89

TABLE 1

TRANSITIONAL SURVEY - TOTAL CAs and RTIAS

CALCULATION OF TOTAL CAs.	
	£ million 1990-91
1. Gross provision	5207
2. add receipts netted off in PES (1)	150
3. less forecast use of accumulated receipts	1225
4. less forecast use of in-year receipts	655
5. less forecast revenue contributions	400
6. less capital grants	725
7. ROOM FOR TOTAL CAs	<hr/> 2353

NOTES:

(1) Repayments of some grants and advances other than mortgages and leasing. These are treated as receipts in the capital control system but not in PES.

TABLE 2: COMPARISON OF BASELINE CALCULATIONS FOR 1989-90 AND 1990-91

A. CALCULATION OF BASELINE CAs: 1990-91

	£ million 1990-91
1. Gross provision	5207
2. add receipts netted off in PES (1)	150
3. less forecast use of accumulated receipts	1225
4. less forecast use of in-year receipts	655
5. less forecast revenue contributions	400
6. less capital grants	725
7. ROOM FOR TOTAL CAs	2353

NOTES:

(1) Repayments of some grants and advances other than mortgages and leasing. These are treated as receipts in the capital control system but not in PES.

B: CALCULATION OF BASELINE CAPITAL ALLOCATIONS: 1989-90

	£ million 1989-90
+ 1 Gross spending (pes)	4975
- 2 non-prescribed spending	850
- 3 receipts netted off pes	-175
= 4 PRESCRIBED SPENDING	4300
5 Spending power from:	
accumulated receipts	3465
in-year receipts	778
trading profits	60
tolerance	192
+ Total	4495
/6 spending power usage	53.0%
- =7 implied spending power	2382
= 8 ROOM FOR ALLOCATIONS	1918
MEMO ITEM:	
Accumulated Receipts	12600
Prescribed Proportion	27.5%
In-Year Receipts	2902
Prescribed Proportion	26.8%

tsm4
1/2/89

TABLE 3: PROPOSED SERVICE BLOCK BASELINE

	Hous.	Trans.	Educ.	PSS	Other	TOTAL
1. CAs	1257	562	320	65	149	2353
2. RTIAs	270	78	49	11	67	475
3. ACGs (1+2)	1527	640	369	76	216	2828

TABLE 4: PROPOSED BASELINE CAs AND CAPITAL GRANTS FOR 1991-92
(uplifted by 2.5%)

	Hous.	Trans.	Educ.	PSS	Other	TOTAL
Credit Approvals	1288	576	328	67	153	2412
Capital grants	461	205	26	5	46	743

"CAPITAL EXPENDITURE AND FINANCE": A CONSULTATION PAPER (7 JULY 1988)

21. The Government will place limits - called credit approvals - on the level of commitments which individual local authorities may enter into in any year and finance by borrowing or credit arrangements. Before the beginning of each financial year, each authority will be told the amount of their basic credit approval for that year. That amount will have been calculated in light of the Government's assessment of the appropriate shares for the authority of the provisions in public expenditure plans for the services administered by the authority. To assist forward planning, each authority will at the same time be given an indication of levels below which their basic credit approvals for the next two financial years will not be reduced. Basic credit approvals may be enhanced by supplementary credit approvals covering particular projects or programmes.

A.17 When issuing to an authority its BCA for any given financial year, the Secretary of State would specify a provisional total for the authority's ACGs for each of the next two following financial years. He would also indicate what allowance he intended to make for receipts in those years. When he came

to issue the final BCA for those years, he would not base them on lower ACGs than he had specified, nor allow for receipts to a greater extent than he had indicated. The Government's present intention is that the total of the provisional ACGs thus specified would be about 85% and 70% of the amount consistent with the relevant public expenditure provisions for BCAs for the two following financial years.

DRAFT LETTER TO SECRETARY OF STATE FOR ENVIRONMENT

LOCAL AUTHORITY CAPITAL (ENGLAND): SETTING PROVISIONAL BASELINES FOR 1989 SURVEY

I am grateful to colleagues for their agreement that we should adopt credit approvals as the main currency for our bilaterals discussions on local authority (LA) capital in the 1989 Survey. I confirm that we shall look at this again at the end of this year.

The next step is to set the baselines for credit approvals and capital grants for the Survey period, and agree a provisional assumption about the level of receipts to be taken into account (RTIA), in order to set Annual Capital Guidelines (ACGs) for 1990-91 at the end of the Survey. It is necessary to reach a firm agreement now on the method of setting the baseline so that the Survey guidelines can be issued within the next week or so. I attach some figures showing what my proposals imply for the baseline. I accept that we should review these figures rather than the method, early in April in the light of any further information about receipts. (Of course the baseline itself is only a starting point for our Survey discussions.)

Our officials, together with those from the other relevant Departments, have considered the baselines for both capital grants and credit approvals in 1990-91. For capital grants, the figures have been estimated directly from the information provided by Departments. For credit approvals, the figures have been calculated by subtracting from the gross provision for each

service block, the likely spending from sources other than credit approvals, that is capital grants, revenue contributions (RCCOs) and use of capital receipts. The method is agreed amongst officials. But there is genuine difficulty in projecting one element within the calculation - the likely rate of spending out of capital receipts.

At present, the assumed rate of spending from available capital receipts for 1989-90 is 53%. In practice, this figure may well exceed 60% next year. For 1990-91, my officials were inclined to the view that it would be appropriate to assume a broadly similar rate of spending: because of the reduced stock of receipts available for spending in 1990-91, the assumed level of spending from capital receipts would have come down by nearly one-third. However, your officials are convinced that not only the level but also the rate of spending from capital receipts will fall more substantially in 1990-91 - as LAs respond cautiously to the new regime. My understanding is that weighing all the considerations my officials and those in other departments were prepared to accept an assumed rate of spending of available capital receipts of 45%: your officials have reserved your position.

Having discussed this with my officials, I would reluctantly be prepared to accept the 45% figure. But I should record my concern that many LAs, having become used to high spending from their capital receipts, and, therefore being committed to a large capital programme, may well sustain a rather higher rate of spending from their receipts in the first year of the new system. I would therefore not be willing to accept a lower spending

assumption. On the basis of the assumption that LAs will choose to spend 45% of the amount available from capital receipts, I propose that we adopt as the baseline a total credit approvals figure of £2353 million, distributed as set out in Table A.

Officials have agreed that the RTIA percentage should be set at 25% for 1990-91, giving a total RTIA of £475 million. Adding this to the total CAs would provide for ACGs at £2828 million.

Officials have also considered how the total RTIAs should be distributed amongst service blocks. The RTIAs (when added to the CAs) will form the ACGs and it is the ACGs which are distributed by Ministers. Accordingly I propose that they should be distributed according to gross provision in the PEWP for 1990-91, as an indicator of our relative service priorities. The figures are displayed in Table A.

It is also necessary to set provisional baselines for years 2 and 3. I suggest that this should be done by applying an uplift factor to the baseline for 1990-91 for capital grants and credit approvals and that a factor of 2½% be adopted ie the same as proposed to grants in LA current for 1991-92 - as shown in table B. For 1992-93, I will be bringing proposals forward at a later stage in line with the usual timetable for setting baselines for the third year.

To help clarify the arrangements for this year's Survey, I attach at Annex A a revised timetable. Our officials have also discussed two aspects of this timetable and Survey arrangements to which I should like to draw attention.

(i) RTIAs: I propose that we review the provisional RTIA figure for 1990-91 in July in the light of the returns on accumulated receipts available for 1988-89. The level of RTIA would be revised to take account of this information, while retaining the 25% assumption and the proposed pattern of distribution. The RTIA would then be fixed by service so that in the bilateral negotiations each £1 change to CAs would equal a £1 change to ACGs for 1990-91.

(ii) Gross LA capital expenditure: I propose that our officials should circulate information on projected total capital spending as it becomes available to inform both the bidding process and the bilaterals. For the year ahead, Departments may wish to publish an indication of their share of the forecast total local authority capital expenditure underlying the GGE forecast using stylised assumptions based on the most recent pattern of outturn spending.

Finally I am conscious that further consideration needs to be given to what is announced about provision for the forward years. Specifically we need to agree what indications should be given

about the future provision for services and for individual LAs, and in what terms any indications should be expressed, bearing in mind the proposals set out in paragraph 21 of the consultation paper that each LA should be given an indication of its minimum basic credit approvals for the two forward years. I am asking my officials in consultation with the other departments involved to consider and make recommendations on this as soon as possible.

I am copying this to the other members of E(LA) and to Sir Robin Butler.

tsm4
1/2/89

TABLE A: PROPOSED SERVICE BLOCK BASELINE

	Hous.	Trans.	Educ.	PSS	Other	TOTAL
1. CAs	1257	562	320	65	149	2353
2. RTIAs	270	78	49	11	67	475
3. ACGs (1+2)	1527	640	369	76	216	2828

TABLE B: PROPOSED BASELINE CAs AND CAPITAL GRANTS FOR 1991-92
(uplifted by 2.5%)

	Hous.	Trans.	Educ.	PSS	Other	TOTAL
Credit Approvals	1288	576	328	67	153	2412
Capital grants	461	205	26	5	46	743

TIMETABLE FOR LA CAPITAL

- | | | | |
|------------|-------------------|-------|---|
| | <u>February</u> | i) | set baselines for credit approvals and capital grants 1990-91 and 1991-92 on provisional assumption about receipts; |
| Baselines | | ii) | set a provisional assumption about RTIA for 1990-91; |
| | <u>April</u> | iii) | finalise baselines in the light of latest data on receipts; |
| | | iv) | create baseline for 1992-93; |
| | <u>May</u> | v) | invitation to Departments to put forward proposals for variations to CAs and capital grants in baselines; |
| Bidding | <u>June</u> | vi) | Departmental letters submitted; |
| | <u>July</u> | vii) | RTIA by department for 1990-91 fixed; |
| | <u>September/</u> | viii) | bilateral negotiations on CAs and capital grants for all three years; |
| Bilaterals | <u>October</u> | ix) | ACGs for 1990-91 formed by adding CAs to RTIA for each service block. |



FROM: A C S ALLAN
DATE: 10 FEBRUARY 1989

ps

PS/CHIEF SECRETARY

cc Sir P Middleton
Mr Anson
Mr Monck
Mr Phillips
Mrs Case
Mr Edwards
Mrs Lomax
Miss Peirson
Mr MacAuslan
Mrs Butler
Mr A White
Mr Wood
Mr Laite

LOCAL AUTHORITY CAPITAL EXPENDITURE: 1989 SURVEY

The Chancellor has seen Mr Potter's minute of 2 February. He thought it was, as Mr Potter says in his paragraph 57, regrettable that the wording of the consultation document was unequivocal in the technical section in terms of the commitment to a future indicator of ACGs.

A handwritten signature in black ink, appearing to read 'A C S Allan', with a long horizontal flourish underneath.

A C S ALLAN