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CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Patrick Jenkin MP
Secretary of State
Department of the Environment
2 Marsham Street
London SW1P 3EB

19 October 1984

Dear Secretary of State

LOCAL AUTHORITY CAPITAL EXPENDITURE -

THE FUTURE OF THE CONTROL SYSTEM

1. Our officials have been considering since E(A) in July how the system of controlling and monitoring local authority capital expenditure could be improved. We need to decide quickly what control system to adopt before we make allocations for 1985-86 at the end of 1984. The present state of uncertainty causes great problems both for us (with a call on the Reserve of unknown, but potentially very large, size this year) and for local authorities (who have had to change their plans mid-year to meet your calls for voluntary restraint).

The problem

2. After earlier underspends, we had an overspend of nearly £400m in 1983-84, and face an overspend probably at least as large as that in the present year. As we have seen we can do little to modify local authorities' spending in-year to deal with overspending problems when they emerge. Our information base is both late and inadequate so that it is impossible to take firm action, or to know the scale of any call on the Reserve. This situation cannot continue.

Our expenditure control objective

3. First, we need to settle in our minds that we intend to make changes to the system with a view to retaining and delivering the national cash limits on local authority capital spending. When we moved in the 1980 Act to control of spending as opposed to just borrowing, we set up cash limits to seek to ensure that the national aggregates of spending accord with the total provision decided upon in the Survey. Local authority capital

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spending is part of public expenditure; its control is essential to our control of public expenditure and to a reduction in the size of the public sector in the economy. A note by officials on the objectives of the capital control system, at Annex A, provides a useful basis for moving on to consider how these objectives can be realised.

4. I should emphasize that I do not see any justification for having an unsatisfactory control system as a way of moderating the effect of our PES decisions. We decide collectively on the provision that can be afforded and should then take the measures necessary to ensure that it is delivered.

Defects of the present system

5. We need then to consider how the present system should be modified, so that our plans are delivered in aggregate. The problems with the present system are a result of the poor match between the sum of local authorities' spending powers and the national cash limits.

6. At present local authorities are given allocations (ie permission to spend) virtually to the level of the aggregate cash limits. They are also given allocations to the value of about half the expected national total of in-year receipts. This part of receipts is thus redistributed among authorities according to need. On top of its allocations, each authority can spend for capital purposes the other half of its own in-year receipts and about half of its own receipts held over from previous years. (By a flaw in the legislation, it can also spend the redistributed half of accumulated receipts again over a period of years.) It can also anticipate or carry forward up to 10% of allocations. And there is also flexibility on so-called "non-prescribed expenditure", which is outside the control system but nevertheless scores against the cash limit. The chart attached shows the very large scope for aggregate overspend implied in this mis-match. Expenditure covered by in-year receipts does not score against the cash limit, but all other flexibilities above the cash limit line imply a potential overspend. We should improve the match if we are to be certain of achieving our public expenditure plans.

Proposals

7. I would prefer to avoid primary legislation, and simply adjust the way we work the present system, to minimise disruption to local authorities, and minimise the inevitable controversy and opposition to our proposals. There are also some areas where I believe we can offer local authorities more flexibility than we do at present, without endangering the cash limit.

8. I propose that we should ensure that the spending power of local authorities does not exceed the cash limit and their expected in-year receipts. This could be achieved as follows.

9. We should retain the general principles of the present capital control system, with the same coverage of the cash limits (DOE/LA1, WO/LA1), with block allocations (which allow 100% virement between services), and with the important principle of the individual local authority's right to use capital receipts to enhance spending power both in-year and in later years. For in-year receipts I propose we retain the present prescribed proportions (50% and 40% (Housing) for most receipts in England, slightly lower in Wales for Housing). These encourage local authorities to dispose of assets, and boost gross spending without creating public expenditure problems. I am also prepared to retain the flexibility for individual authorities of allowing them to carry forward or anticipate 10% of allocations, in recognition of the difficulty of exact programming of capital spending on an annual basis. I would propose no change in our controls on borrowing or contributions to capital from the revenue side, as I believe our first priority should be better control of spending, rather than the financing of that spending.

10. We should change the way we run the system in one of two ways to reduce the present dangers to the cash limit:-

Option A

(i) we should arrange that only 10% of the estimated £4bn of accumulated capital receipts can be used in any one year, instead of the present much higher proportions - 50% and 40% for most receipts.

(ii) in distributing cash limit provision, we should take account of the spending power implied by the various flexibilities (10% accumulated receipts, the 10% end year tolerance on allocations, the expected level of non-prescribed expenditure) to match the total of local spending power with the national provision and the cash limit. The one exception would be in-year receipts.

Option B

(i) we should end the practice of redistributing part of in-year receipts among authorities so that

(ii) use of a larger proportion of accumulated receipts can be accommodated. The proportion might be 25%, to provide a greater incentive to continue disposals, and a greater relative reward to authorities which have made disposals compared with those which have not, provided that

(iii) the total of allocations (including use of accumulated receipts), the prescribed proportion of in-year receipts and the other flexibilities (end-year tolerance and non-prescribed expenditure) does not exceed the cash limit plus expected in-year receipts.

... These options are illustrated in the attached chart.

11. The limitation on accumulated receipts can be achieved under present legislation by removing local authorities' right to use receipts from previous years, but including in their allocation an element equal to 10% (or 25%) of the level held. We do not at present have information about individual authorities' accumulated receipts holdings, but they would have every incentive to let us know so that they could receive the relevant allocations. This process could be repeated each year, so that any receipts not spent in-year are not lost, but added to the individual authority's total, on which the 10% (or 25%) could be calculated each year.

12. We could on the other hand <u>help local authorities to work within a more effective control system</u>, as follows:-

(a) we could help authorities' forward planning by extending to all service blocks the forward indications now given of housing and 'Other Service' allocations;

(b) we should undertake to review urgently the remaining project controls still operated by central government departments with a view to removing them or further simplifying them wherever possible. They are expensive in manpower as well as a source of irritation to local authorities; and

(c) if either option A or option B is agreed in full, I would be prepared to consider a change from the present 2% end-year flexibility on the national cash limit to 5%. This would ensure that resources would not be lost to local authorities while they adjusted to the new arrangements.

13. I propose that we make an immediate announcement and introduce these changes in making allocations for 1985-86. The new 10% or 25% proportion should in principle apply to the unused balance of accumulated receipts at 31 March 1985, and at the end of subsequent financial years. In practice, since allocations should preferably be made before the start of the financial year, it might be necessary to use the figure at the end of 1983-84, or to use local authorities' estimates for the position at end 1984-85. We should seek urgently the necessary information about accumulated capital receipts from authorities. If they do not provide this promptly we could either make our own estimate to use in allocations (based on our knowledge of the level and use of receipts since 1981) or issue this element of allocations slightly later than the basic allocations.

14. I recognise that such an announcement will not help us minimize this year's cash limit breach. It will reduce the incentive for authorities to increase receipts in 1984-85, as they may be tempted to delay receipts into the new financial year so that they can use half in that year, rather than 10% or 25%. But we can counter this by emphasizing to authorities that any cash limit breach will have to lead to reductions in later years, so that it is in their own interest to minimize the overspend.

15. We cannot expect any proposals for improving control to be popular with local government. Judging from comments made by the Associations they will attack any reduction in their access to "their savings" in the form of accumulated receipts. Against this we can argue that they have of course already used the cash eg to reduce debt, and that with redistribution - and due to an error in drafting in the Act - half the receipts can be spent twice by authorities under the so-called "cascade" effect. They will also criticize the annuality of the control system. But we can point out that we are mitigating this both at local level by 10%, and at national level by 5%. More would be impracticable within the overall framework of annual public expenditure accounting. We would also be able to point to our commitment to review project controls and to give better forward indications.

16. I am sending copies of this letter to members of E(A), Leon Brittan, Norman Fowler, Keith Joseph, Grey Gowrie and Sir Robert Armstrong.

Yours sincerely

Richard Broadbent

for **PETER REES**

[Approved by the Chief Secretary]

ANNEX A

CPWP(84)12

CAPITAL PROGRAMMES WORKING PARTY

OBJECTIVES OF THE CAPITAL CONTROL SYSTEM

In their letter of 11 September 1984 to the Secretary of State, the Chairmen of the AMA, ACC and ADC asked for a statement on the objectives of the capital control system.

2. When the Government legislated for the control of local authority capital expenditure in the Local Government, Planning and Land Act 1980, it had a number of objectives.

3. The first was to control aggregate local authority capital expenditure in line with the Government's public expenditure plans. Local authority expenditure is part of total public expenditure. Control of public expenditure is essential (a) for implementation of the Government's medium term financial strategy to reduce the public sector borrowing requirement, lower inflation and interest rates and (b) for the Government's policy of reducing the role of the public sector. It is also helpful for a control system to cover related borrowing, because borrowing for capital purposes is an element of the LABR, itself a part of the PSBR.

4. The second was to help in the objective of reducing the role of the public sector by encouraging the disposal of assets. The present control system was designed to this end, in conjunction with the Right to Buy legislation.

5. The third was within overall Government expenditure plans for local authority capital expenditure, to promote a good match between the availability of resources and the incidence of need, taking into account the Government's service priorities. This required a measure of control over the distribution of expenditure and/or borrowing. There were two elements: the distribution of resources between authorities and the direction of resources towards the Government's own policy priorities.

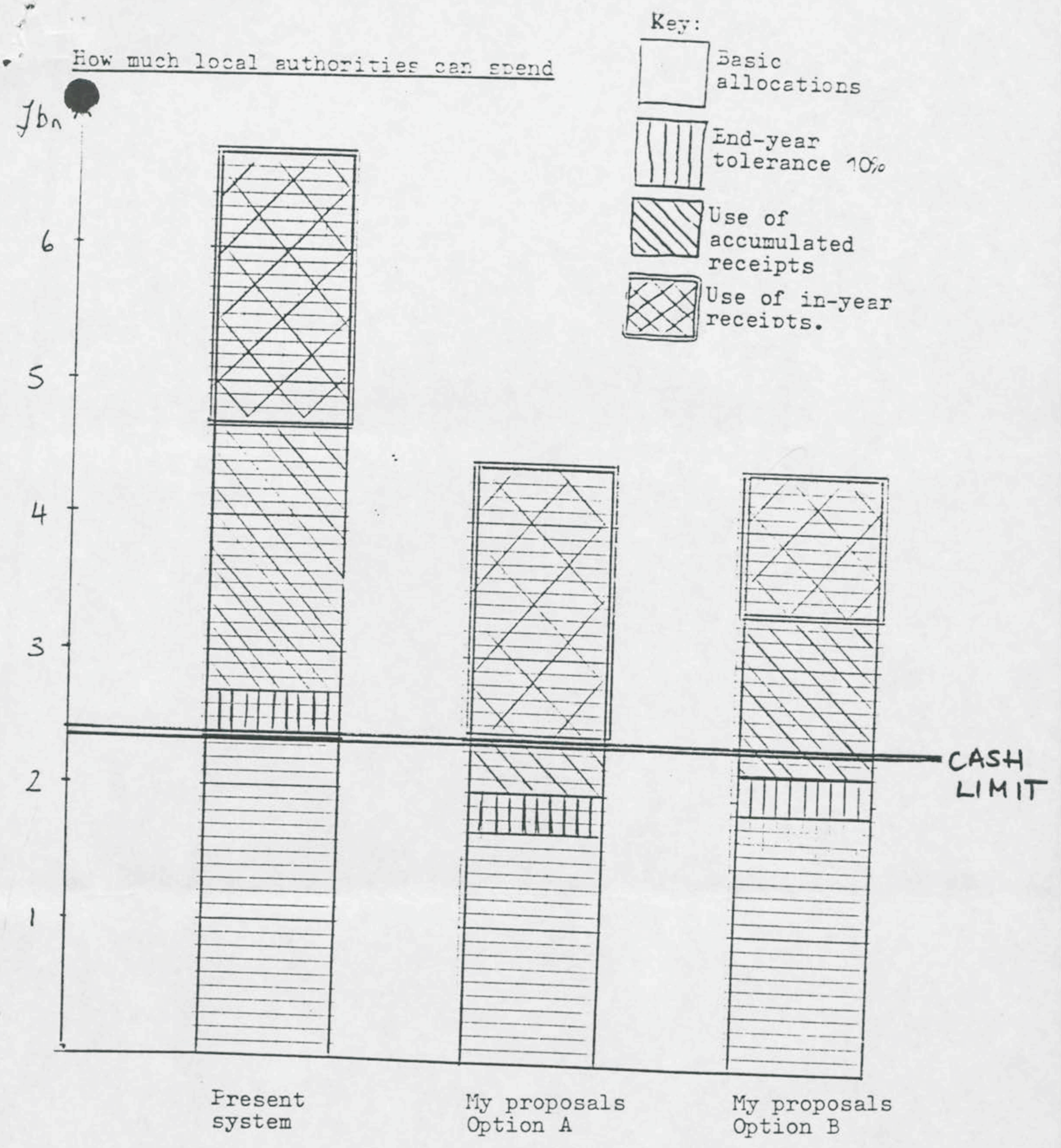
6. The fourth was to provide local government with a workable system which promoted cost effective capital programmes and which maximised freedom within the limitation necessarily imposed in pursuit of the other objectives. Capital projects may have long lead times and the workload has to be planned to match the available staff and other resources.

7. These are the objectives which the Government has had in view in operating the capital control system since 1981/82. The views of the local authority associations on the balance between these objectives would be welcomed.

FLAR Division
Department of the Environment

October 1984

How much local authorities can spend



Figures are illustrative only. Based on 1984-85 cash limit in England

NBPM AT 25/10

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:

Your ref:

25 OCT 84

Dear Peter,

Thank you for your letter of 19 October about the control of local authority capital expenditure 1985/86.

I agree with you that the present arrangements are not working satisfactorily. But your proposals for a very severe tightening of the controls and cutting off use of accumulated capital receipts would be immensely controversial, and would cause uproar among our own local authority supporters. The shire district councils are particularly dependent on such receipts to maintain their capital programmes. They would be very difficult to operate in practice. For 1985/86, they would cause havoc to the plans authorities have been making to use their receipts.

This sort of disruption of prudent, local planning of expenditure and its finance is very destructive of value for money. It would be obvious that we would get less, rather than the more we need, from the money that actually got spent. For later years it would lead to chronic underspending on what is in any case a reducing provision, at a time when the pressures adequately to maintain and replace our capital stock will be intensifying. Coming on top of all our other battles in the local government area, it would be utter folly for us to embark on yet another major confrontation over this issue.

It would also be highly provocative to rush into a very major change to the present system at short notice and at a time when we have just started on a consultative process with local government about the defects of the present arrangements, and possible changes for the future. The Audit Commission will also shortly be reporting on this.

Your concern about the total of capital receipts which local authorities have accumulated over the past years from the sale of assets arises from the emphasis which you place on the first of the objectives described in the note attached to your letter. But the other three objectives described there are equally valid. There is a problem of reconciling them, but to promote one to the virtual exclusion of the other three is no solution.

I should remind you that we have held it out as a major incentive to authorities that they would be able to spend their receipts over time to supplement their capital allocations. It is a major part of our strategy to get assets out of the public sector, and with local authorities we have been very successful indeed. Prudent authorities (particularly our own supporters) did not rush into spending these receipts as soon as they arose, but have been building up their reserves, and working up their plans for making use of them gradually. It would be seen as a major breach of faith if we now try to prevent authorities using those capital receipts (or what comes to the same thing, reduce total allocations by the amount of accumulated receipts which they are permitted to use). It would also be seen as a clear and evident U-turn away from effective encouragement of the sale of local authority assets.

I do not believe that drastic action on these lines is in any case necessary or appropriate. The problem of accumulated receipts must after all be a temporary one. In 1981/82 and 1982/83 receipts came in much faster than authorities could spend them, leading to accumulation of receipts and "underspends" in those years.

Looking forward, we can foresee a sharp downturn in the level of receipts over the next few years as council house sales pass their peak. Local authorities will need to make use of the good harvest of receipts they have accumulated in the past few years in those lean years ahead, and the "problem" of accumulated receipts will therefore automatically unwind over this period. Your proposal would amount to commandeering the benefit of that harvest, which the authorities had prudently laid by for their own use. It would undermine their forward planning, and would seriously damage our good faith.

My own view is that the difficulties we have in controlling expenditure to the present form of cash limit are largely of our own making. Prior to 1980 Government did not seek to control capital spending as such. Instead we exercised control over borrowing by local authorities for new capital, and used the total of borrowing allocations or loan sanctions as the control total. I believe that a variation on that system could be made at least as effective as our present arrangements in influencing the total level of local authority borrowing and hence the PSBR, if we made borrowing approvals available on an annual basis as the local authority associations have recently suggested to us. That is the approach towards which we should steer for 1986/87 and beyond.

I recognise that this would require a significant change in the present PESC conventions.

Clearly it would be difficult at this late stage in the PES round - and before we have talked to the associations - to change the system altogether for 1985/86. But neither should we rush into the savage and deeply controversial tightening which you propose of the present arrangements, which are aimed at the wrong target.

My own proposal for 1985/86 is that we should retain basically the present system for capital allocations pending a deeper review for the following year. When we have settled the capital provision in the Star Chamber or elsewhere we shall of course need to consider the variable parameters of the system, including in particular with withholding of a part of their allocations from those authorities which have not complied with our request to cut their expenditure in this year. We should also consider whether to tighten up the prescribed proportion of receipts that authorities may use in the year to supplement their allocations. But even a small reduction in the prescribed reduction would produce a strong reaction from local authorities, and we must retain much more flexibility than your proposals would allow.

The problem of accumulated receipts can be expected to unwind itself over a period of years, and we should not allow ourselves to over-react especially by damaging mid-year charges of course if in any one year local authorities make use of more of their accumulated receipts than we had anticipated, thus scoring technically as an overspend.

I am copying this to the Prime Minister, the other members of E(A), Leon Brittan, Norman Fowler, Keith Joseph, Grey Gowrie and Sir Robert Armstrong.

Yours ever
Patrick

PATRICK JENKIN

The Rt Hon Peter Rees QC MP

LOCAL GOVT: Relations Pt 23

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DEPARTMENT OF EDUCATION AND SCIENCE

ELIZABETH HOUSE, YORK ROAD, LONDON SE1 7PH
TELEPHONE 01-928 9222
FROM THE SECRETARY OF STATE

Rt Hon Peter Rees QC MP
Chief Secretary
Treasury
Parliament Street
SW1P 3AG

9 November 1984.

Dear Peter.

LOCAL AUTHORITY CAPITAL EXPENDITURE: THE FUTURE OF THE CONTROL SYSTEM

Since collective discussion of this matter has for the moment been deferred, I am writing about your letter to Patrick Jenkin of 19 October and his response of 25 October. I see that other colleagues have also written.

I share your determination that an effective control system for the future must be worked out and that steps must be taken to avoid further large overspending in 1985-86. But I share Patrick's view that we should not rush into a new system. The issues are very complex and we cannot afford politically to get the arrangements wrong the second time round. More work is needed from officials, and we could, I believe, also learn from the local authority associations. I think that we should concentrate immediately on what is to be done for 1985-86, and that whatever is decided for that year should be without prejudice to longer term arrangements.

So far as 1985-86 is concerned, your original proposals which from your letter of 2 November I see that you are now reconsidering were defective from my point of view in two essential respects. First, you suggested deductions in respect of end year tolerance and "non-prescribed" expenditure from the total sum to be distributed by allocation to authorities. This would have effectively reduced the level of resources on which we agreed for education capital expenditure at our bilateral. That agreement was on the basis of the present rules and I could not accept a change which would amount to a cut in an already attenuated quantum. Secondly, the way in which you proposed, under either "option", to pre-empt an element in allocations so as to preserve the appearance of some access to accumulated receipts would have unacceptably restricted my discretion in making allocations on criteria of need. Taken together, these two features would have left

cont/d

me with insufficient resources in the coming year to assure all authorities of cover for their minimum statutory and contractual obligations and would have left many with nothing for essential value-for-money purposes such as taking surplus school places out of use.

I am copying this letter to the Prime Minister, Patrick Jenkin, the other members of E(A) and E(LA), Leon Brittan, Norman Fowler, Grey Gowrie and Sir Robert Armstrong.

Yours ever,

Keith.

Relations : LOCAL GOVT. Pt 23.

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Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

Alan Davis Esq
Private Secretary to the
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
London SW1P 3EB

8 November 1984

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Dear Alan,

CONTRACTING OUT OF LOCAL GOVERNMENT SERVICES

Your Secretary of State wrote to the Chancellor on 6 November and you subsequently gave us an amendment to the draft text enclosed with his letter.

As I explained to you on the telephone, we are content with the amended announcement, only on the clear understanding that the consultative document will include the full list of activities to be proposed for competitive tendering, as agreed in the minutes of E(A)(84)24th Meeting, ie refuse collection and street cleaning, cleaning of buildings (schools, offices etc), landscape maintenance (parks, sports grounds etc), vehicle maintenance, school meals and centralised catering.

I am sending a copy of this letter to Andrew Turnbull (No.10), to the Private Secretaries of the other members of E(A), to Hugh Taylor (Home Office), Elizabeth Hodkinson (DES), Steve Godber (DHSS) and Richard Hatfield (Cabinet Office).

Yours sincerely,

Margaret O'Mara

MISS M O'MARA

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AT 12/11

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

9 November 1984

Dear Chief Secretary

SS/Wales to CST?

Thank you for your letter of 2 November about local authority capital controls.

I am worried about the way time is passing. If we are to issue capital allocations in December as usual - and there will be a very reasonable outcry if we fail - the timetable is becoming critical. Even more immediately, once the provision for next year is announced in the Autumn Statement, I expect to come under heavy pressure to say what sort of regime will be applied. Authorities' forward planning has been seriously unsettled by this year's mid-year action and it is urgent that they should know what resources they can rely on for next year.

We shall therefore be in real difficulty if we do not take decisions very shortly. I see no prospect now of agreeing a regime for 1985/6 which differs in major respects from the existing system. This rules out anything like your proposals or those put forward by Nick Edwards, at least for next year. In any case, as you know, I believe that what you have proposed would produce uproar in local government; Nick's proposals too would create difficulties in England.

We must of course continue to look at the way the system can be improved for subsequent years, honouring our promise to discuss that issue with the local authority associations as part of our consideration. In the meantime, I propose that for 1985/6 we should stick close to the present regime, though in order to improve prospects for the delivery of the cash limit I am prepared to see a modest reduction in the prescribed proportion for those housing receipts which are now at 40%.

I hope we can reach agreement on these lines within the next few days.

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I am copying this to the Prime Minister, to the other members of E(A), to Leon Brittan, Keith Joseph, Norman Fowler and Grey Gowrie, and to Sir Robert Armstrong.

Yours sincerely

AHDavis

for PATRICK JENKIN

Approved by the SofS and signed in his absence

The Rt Hon Peter Rees QC MP

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AT

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CCNO

PAYMASTER GENERAL

CABINET OFFICE
70 Whitehall,
London SW1A 2AS
Telephone 01-233 3340

8 November 1984

Dear Peter

LOCAL AUTHORITY CAPITAL EXPENDITURE

I am wholly sympathetic to your concern about the cost of capital spending by local authorities. They would themselves admit how damaging are the sudden changes of gear which have become inevitable because of the lack of such control. Nevertheless I am very concerned at the psychological effect of saying to prudent local authorities, overwhelmingly in Conservative areas, "Your money, which you raised by doing what we told you, and which we promised you could spend, can't now be spent". It puts us at loggerheads with many people in local government who have so far supported us very loyally; is extremely difficult to explain; and will be widely interpreted as another Governmental mess produced by people who dislike and don't understand local government. Mr Parker-Jarvis will gain some considerable support from his colleagues from the stand he is taking in any case. Far more so if we undermine this understanding which they feel they have with Government. Most of our efforts to legislate about local government arise because the old consensus has been attacked by the militants. It would do serious damage if we had to legislate to keep our own people in check!

I am sending a copy of this letter to the members of E(A), Leon Brittan, Norman Fowler, Keith Joseph, Grey Gowrie, and to Sir Robert Armstrong.

Yours ever

John

JOHN SELWYN GUMMER

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON SW1 3AG

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SENO

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
HM Treasury
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

7 November 1984

Dear Peter

LOCAL AUTHORITY CAPITAL CONTROLS

I have seen a copy of Nicholas Edwards' letter of 2 November, and was attracted by his proposals for dealing with the overhang of capital receipts in 1985-86.

There is no doubt that the present capital controls system has failed as a means of delivering the national cash limit. The cause has been the accumulation of capital receipts which allows local authorities collectively to spend way above the cash limit without breaching the rules which apply to them individually. Your own proposals for curbing the use of accumulated receipts would be politically difficult and would involve cutting local authorities capital allocations by more than we have agreed in the PES round; but, equally, we cannot simply allow the problem to unwind at its own pace.

The solution, therefore, would seem to be not to change the method of making allocations, but to oblige local authorities to make use of their receipts quickly in order to spend up to their allocations; and I think Nicholas Edwards has struck on an ingenious way of doing that, by reducing

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authorities' borrowing power to reflect their spending power from receipts. This proposal has the advantage that it could be in place in 1985-86, though we would need to establish individual authorities' holdings of receipts before we could set borrowing limits.

For the future we will have time to consider all the options for changing the present system and to consult as necessary. I shall be writing soon with my own thoughts on that.

I am sending copies of this letter to members of E(A), Leon Brittan, Norman Fowler, Keith Joseph, Grey Gowrie and Sir Robert Armstrong.

Yours ever

Nicholas

NICHOLAS RIDLEY

Local Govt. Relats Pt 23

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Y SWYDDFA GYMREIG
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switsfwrdd)
01-233 6106 (Llinell Union)
Oddi wrth Ysgrifennydd Gwladol Cymru

WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switchboard)
01-233 6106 (Direct Line)
From The Secretary of State for Wales

The Rt Hon Nicholas Edwards MP

2 November 1984

Dear Peter

File with AT

LOCAL AUTHORITY CAPITAL CONTROL SYSTEM

Thank you for copying to me your letter of 19 October to Patrick Jenkin about the control of local authority capital expenditure. I have also seen Patrick's reply of 25 October.

The one thing we all agree on is that the existing control mechanisms have not been operating successfully during the last few years. I share your view that we ought to try and improve them for 1985-86. The local authority associations in Wales are also keen for improvements: they recognise that the present system is not delivering the required results, but are fearful of over-reaction on our part.

Before commenting on the proposals put forward by Patrick and yourself I think it would be worthwhile setting out my perception of the overall problem, together with the way in which I feel a better balance could be struck between the justifiable requirements at both local and national levels.

The present emphasis on annual cash planning does not offer the prospect of managing capital programmes in the most efficient and effective manner. We are constantly reminded of this by the associations, and I have no doubt the Audit Commission will come to precisely the same conclusion when it reports on the control system in a month or so. Nonetheless, I believe we are bound to concern ourselves with the totality of local authority capital expenditure in any one year because of the effect it may have on our wider plans for the relationship of public spending with GDP. The central issue, therefore, is the degree of precision it is realistic to aim for in a set

/of programmes ...

Peter Rees Esq MP
Chief Secretary
Treasury Chambers
Parliament Street
London
SW1P 3AG

of programmes so wide-ranging, complex and, in terms of our operational control, so remote. I am firmly of the view that we created a rod for our own backs in attempting cash limit control in this area. A far better approach would be to seek to ensure that net capital spending falls within an acceptable range which does not upset our plans for public expenditure as a whole. Such a range might span 10 per cent either side of a target set for net expenditure.

Under this scheme the basic rules we have now about carrying forward underspends and offsetting overspends would apply, but I would suggest that the maximum carry-forward or offset should be 10 per cent at both local and national levels.

In order to inject an even greater degree of certainty into the system it would also be necessary, as you suggest, to offer individual authorities a far better view of the future level of resources at their disposal. As you know I have already agreed to provide authorities in Wales with forward indications of capital resources right through the PES period. However, the utility of these indications for the future years is considerably diminished by the fact that they are linked to 80 per cent and 70 per cent (in years 2 and 3 respectively) of the levels published in our plans. I would wish to improve upon this, and have in mind offering authorities indications linked to 90 per cent of the sum estimated to be available for allocation in the last two years of the survey period.

I turn now to the vexed question of accumulated receipts. It is, of course, true that a good part of the problem presented by them is due to the fact that, whilst we have built in to the allocations a proportion of estimated receipts, authorities have been able to borrow against the total allocation, hoarding the receipts themselves for future use. I find some difficulty in criticising local authorities for this when the system has been operated in such a way (with 100 per cent borrowing approval) as to encourage them to respond in this manner. It would surely be indefensible to turn round now and deny them the use of the receipts: there is on the other hand a good case for some restraint on that use. In order not to encourage authorities to continue accumulating receipts, further thought needs to be given, however, to the future level of borrowing approval under a scheme devised along the lines I suggest in this letter. A good case would need to be made out, in my view, for offering borrowing approval in excess of aggregate net capital provision.

When it comes to allocation to authorities for a particular year, I am sure that the present system needs to be changed. However, your suggestion that they should only be able to top up allocations using the uncertain spending power associated with new receipts is not acceptable, since it would be inimical to sound planning and the achievement of value for money. All the evidence suggests that authorities plan on the basis of their best estimate of future capital allocations and the level of accumulated receipts: new receipts hardly ever figure. We ought to recognise this. I would, therefore, make allocations as follows.

There would be a gross expenditure figure underlying our central target figure for net expenditure, as now. Starting with that gross figure, the

/total available ...

total available for allocation would be arrived at by deducting a proportion (the prescribed proportion) of all receipts (accumulated and forecast new receipts), together with a realistic allowance for non-prescribed expenditure. This total quantum of allocations would be distributed as now, and authorities positively encouraged to enhance their allocations by applying the full prescribed proportion of all receipts. If the sums are done correctly both gross and net expenditure would be within an acceptable distance of our plans, and over a period the present accumulation of receipts would be unwound provided, of course, borrowing approval (certainly in the case of housing) was less than the total of capital allocations. This could all be done under the existing law, and I see no reason why it should not be done for 1985-86.

In contrast to this scheme, Patrick's proposals transfer the emphasis to borrowing limits, and (implicitly) depend on revenue side pressures. Were we not so concerned with the aggregate level of expenditure I believe his scheme would have a great deal to commend it. However, it would only be a runner, in my view, if investment met out of accumulated receipts could, somehow, be classed as 'below the line' for planning purposes, so removing the threat to our over-riding objective of reducing public expenditure as a percentage of GDP over the life of this Parliament.

I have a further concern about Patrick's proposals. Both he and I would like to rid ourselves as quickly as possible of revenue targets. Quite clearly, given our experiences over the last two years, it would be necessary to adopt an even tougher stance on revenue account if it is required not only to resist the continuing pressure for additional current expenditure, but also the increased demand for capital expenditure that an unfettered use of accumulated receipts would undoubtedly generate in the short term. I could not possibly accept any greater restriction on current spending than presently envisaged in our plans, and I would not consider it sensible or realistic to trade looser capital control for major cuts in aggregate grant or the retention of targets.

As regards the schemes you suggest, the rigid annuality inherent in them, and the emphasis on within year receipts, would, as I have already indicated, seriously undermine our drive for better capital planning and value for money. They would deprive authorities of direct access to their own accumulated receipts, which I believe would be indefensible. While the general distributional effect of your proposals would not differ sharply from that underlying my scheme, the political advantage of being able to offer authorities continuing access to their accumulated receipts would be considerable. As Patrick rightly says there would be an uproar amongst local authorities across the entire political spectrum if accumulated receipts, despite all our past assurances, were effectively removed from the system using a device in the 1980 Act which none of us at the time ever thought we would use for that purpose.

I am committed to consulting my local authority associations on possible changes to the control system, and options for 1985-86. I have arranged a meeting of the Welsh Consultative Council for 12 November for this purpose. I would not expect any of the possible options to command support on the local authority side, but my understanding is that the Welsh associations

/would be prepared ...

would be prepared to comment constructively on the problem. I believe that a genuine willingness to take their views into account in framing the final proposals will pay dividends in the longer term. I shall, therefore, write again when I have heard their views. In the meantime my officials will clear with yours the paper to be tabled for that meeting, which will be a rehearsal of the objectives of each side and broad options for the way forward.

/ I am copying this letter to Members of E(A), Leon Brittan, Norman Fowler, Keith Joseph, Grey Gowrie and Sir Robert Armstrong.

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CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Sir Keith Joseph MP
Secretary of State
Department of Education and Science
Elizabeth House
York Road
London
SE1 7PH

1 November 1984

Dear Secretary of State,

LOCAL AUTHORITY CAPITAL EXPENDITURE -THE FUTURE OF THE CONTROL SYSTEM

Thank you for your letter of 30 October.

I hope on reflection you would not see any conflict between my proposal to tell the authorities that we are reviewing urgently our remaining project controls and our agreement to a review of the functions of your Architects and Building Group. Indeed the thought in my mind was that, since the A and B review will inescapably (whatever the final terms of reference, on which we await your proposals) be looking at project control we could usefully take credit for the fact in our discussions with the Associations about the capital control system. It was certainly not my intention to prejudge the outcome. A commitment to a review with a view to removing or simplifying remaining controls <u>wherever possible</u> - the words were chosen with some care - is no more than that. It would not inhibit us in any way from concluding, were the results of the review to justify such a conclusion, that it would be impracticable to simplify your project controls any further.

Meanwhile, the continued existence of project controls is a perennial source of (possibly ritual) complaint by the authorities, and commitment to an independent study of them would remove an obvious pretext for resistance to the tightening up of the capital control arrangements which we both believe to be essential. I am clear however that an offer of a review which excluded education building - the major area in which such controls still apply - would cut no ice at all with the Associations.

I am copying this letter to members of E(A).

Yours sincerely

Paul Fegler

p ~~PETER REES~~

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

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NBPM 1/11

SECRETARY OF STATE FOR TRANSPORT

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
HM Treasury
Parliament Street
LONDON SW1 3AG

1st November 1984

Dear Chief Secretary,

LOCAL AUTHORITY CAPITAL EXPENDITURE

I have seen the correspondence between you and Patrick Jenkin about the control of local authority capital expenditure.

I share your concern about the ineffectiveness of the present control system. But we cannot ignore the political and practical difficulties of tightening it up. After encouraging authorities to increase their spending in 1982-83, we have now asked them to exercise restraint this year and in the current PES round we are reducing provision for local authority programmes to offset the previous overspend. We are in danger of creating a most unstable stop-go situation and I agree with Patrick Jenkin that if we make an across-the-board cut in allocations, as you suggest, it will lead to chronic underspending in later years.

The heart of the problem is, of course, the amount of accumulated receipts which authorities can draw on. I fully recognise the difficulties that Patrick Jenkin mentions in restricting the use of these receipts, and that the problem

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will work itself out over the next few years. In the meantime, however they are a destablising factor and we must take some corrective action.

Both of your options would involve an across-the-board reduction in the allocations which are derived from the net provision in our public expenditure plans. But the problem arises mainly from the capital receipts generated by the right to buy. The relation between allocations and spending power is therefore different for different services and classes of authority. So far as my own programme is concerned capital receipts are very small and there is no problem of overspending. So to tighten the controls as you suggest would in practice amount to a further cut on top of the reductions we have agreed in the bilaterals. I cannot accept this.

Similarly there is no overall problem of controlling expenditure by the shire counties, which do not have a large bank of accumulated receipts to draw on - we do not have a precise breakdown, but I understand that in 1983-84 they generated only about £150m of the national total of over £2bn. To reduce their allocations to offset end-year flexibility would be seen as a 10% cut on top of the service cuts we are making. It would therefore cause great resentment amongst our supporters at being penalised for a problem which is not of their making.

I therefore agree with Patrick Jenkin that for next year we should consider some reduction in the prescribed proportion of receipts which authorities may use in the year, but I could not agree to any reduction in allocations to offset end-year flexibility.

I hope that we shall have an early opportunity to discuss this collectively.

I am copying this letter to the Prime Minister, the other members of E(A), Leon Brittan, Norman Fowler, Keith Joseph, Grey Gowrie and Sir Robert Armstrong.

Yours sincerely,

Dinah Nichols

pp NICHOLAS RIDLEY

approved by the Secretary of State & signed in his absence

Local Govt: Relations : Pt 23.

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Caxton House Tothill Street London SW1H 9NF

Telephone Direct Line 01-213 6400

Switchboard 01-213 3000

The Rt Hon Peter Rees QC MP
Chief Secretary to the
Treasury
Parliament Street
LONDON SW1P 3AG

31st October 1984

Dear Peter,

LOCAL AUTHORITY CAPITAL EXPENDITURE

I have seen a copy of Patrick Jenkin's letter to you of October 25th about the proposal for preventing the use of accumulated capital receipts.

I note that your actual proposal is not a total disqualification of accumulated receipts, but to allow only ten per cent in any one year. I must warn you that this certainly would be seen as a major breach of faith by our own supporters and would put myself and one or two other colleagues in a particularly difficult position. We devoted a considerable amount of time to encouraging local authorities not only to accelerate their sales of council houses but also to dispose of surplus land and other assets. A key point in our argument was the opportunity that it gave them to recycle these funds. It would be most embarrassing if the effect of the new arrangements would be to hit hardest those who had not rushed out to spend immediately but had taken some trouble over the preparation of proper and worthwhile schemes.

I recognise the difficulties involved in local authority capital expenditure control. They flow directly from the success of the Right to Buy and the consequent growth of capital receipts. That is why, in any proposals to further limit local authority capital expenditure, it is vital that we recognise the particular sensitivity of changing the rules on these receipts.

I am copying this to Patrick Jenkin, the other members of E(A), Leon Brittan, Norman Fowler, Keith Joseph, Grey Gowrie and Sir Robert Armstrong.

Tom

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Local Govt Pts

MR TURNBULL 16 November 1984

E(LF): REVIEW OF LOCAL FINANCE

Patrick Jenkin's plan seems admirable in most respects. He identifies the central issues - confusion, lack of accountability, lack of democratic pressure for low spending - and he sensibly suggests that the ground should be prepared informally before moving into formal review groups.

Our one quibble is that the timetable seems a little lethargic, even given the other activities of DoE. These operations tend to take longer than anyone plans; we suspect that if two years are allowed for the whole project, it may in the event take almost three years to complete. This would be too late. We therefore suggest that he should aim at three months for phase one and nine months for phase two, instead of the six months and 12-18 months that he proposes.

OLIVER LETWIN

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F

For E(A) meeting

cc NO
CCOL

Y SWYDDFA GYMREIG
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switsfwrdd)
01-233 6106 (Llinell Union)
Oddi wrth Ysgrifennydd Gwladol Cymru

WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switchboard)
01-233 6106 (Direct Line)
From The Secretary of State for Wales

The Rt Hon Nicholas Edwards MP

16 November 1984

Dear Chief Secretary

LOCAL AUTHORITY CAPITAL CONTROL SYSTEM

In my letter of 2 November I said that I would write again after consulting the Welsh local authority associations on the basis of a range of options which broadly mirrored those put forward by you, Patrick and myself.

The associations' response to the consultation paper was constructive, if predictable. They are clearly very frustrated and annoyed at what they perceive to be the gross mis-management, at the national level, of a key area of their activity. The rigidity inherent in the cash limit regime came in for particular criticism, and they insisted on their right to use the receipts which they had accumulated, often for later use in connection with specific projects, though they did not argue that they should be free to do so all at once. They re-affirmed their support for forward indications of individual alloations, and for the largely formula-based arrangements we have in Wales for determining the allocations themselves. However, they pressed for the forward indications to represent a higher proportion of the sum available for allocation in each of the future years.

It is against this background, and my previously expressed views, that I comment on your current paper for E(A). I believe that the proposals outlined in that paper form the basis for agreement, certainly in Wales, provided you can accept the following adjustments.

First and foremost I am totally convinced, even if the sector were to remain cash limited, that the unique factors which apply to this area of spending demand that special rules apply. I acknowledge that you are already prepared to accept that there should be flexibility for an underspend, albeit of 5 per cent rather than the 10 per cent I suggest. However, the real point is that local government capital spending will never be susceptible to the degree of control you want. We must recognise this; and the proposal outlned in my letter of 2 November envisaged equal flexibility above the target as well as below it. Only if net spending appeared to be on course to exceed the flexibility margin above the cash limit would remedial action be necessary. Year to year tolerance would take account of disparities of a lesser order. This concession would go a very long way towards meeting the reasonable criticism that we are seeking to control the uncontrollable.

/...

The Rt Hon Peter Rees QC MP
Chief Secretary to the Tresury

My second concern relates to the prescribed proportion of receipts. You suggest a standard proportion for all services of 15 per cent. At present only housing receipts are subject to a prescribed proportion in Wales (25 per cent in the last two years). There is no compelling case that I can see for introducing a prescribed proportion for other receipts in Wales. The counties have not contributed to my problems in the current year, and districts have only been able to exceed their non-housing allocations by making use of the spending power given by their housing receipts. A lower prescribed proportion for housing receipts would significantly reduce their ability to effect such a transfer. Nevertheless, provided you are willing to concede a 'no-action' margin above the cash limit such as I have suggested I would be prepared to introduce a prescribed proportion of 50% for non-housing receipts. To avoid additional pressure on the cash limit from this I would propose not to change the allocation total for these services from the **net** basis presently adopted in Wales.

In the case of housing, the decision on the level of the prescribed proportion is circumscribed by the aggregate amount of forward indications already offered for the year, and the political importance attached to the headline figure for housing allocations compared with that in the present year. It could be argued that a substantial reduction in the prescribed proportion would act against our policy objectives by reducing the incentive to an authority to generate new receipts. There is something in this, but the major part of this flow of receipts is generated not by the authority itself but by would-be purchasers; and a further substantial component is the repayment of local authority mortgages. The actual prescribed proportion selected is for me to decide in the light of Welsh circumstances, but seems to me likely to lie between 10 and 20 per cent.

On the question of forward indications, I have expressed a preference to link them to 90 per cent of the estimated amount available for allocation in the future years. You are understandably cautious about this. I would be prepared to settle on a compromise figure of 80 per cent for both years if you were, again, prepared to move on the issue of a flexibility margin above the cash limit.

As regards the borrowing cover of allocations I am still uneasy about the double-financing element inherent in the system. However, I am prepared to agree that this should be left for examination before 1986/87 allocations are determined. I think we should make it clear to the associations that we intend examining this area, in order to avoid charges that we are misleading them by not saying in advance that, from henceforth, the forward indications might not carry 100 per cent borrowing cover.

/...

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If you and colleagues can agree to my suggestions in this letter I would be prepared to introduce such a revised system in Wales for 1985/86, subject to one extremely important proviso. I believe that the revised system would be considerably more effective than the present one. If the arrangements agreed for England for 1985/86 are different in any important respect, and give rise to an uncorrected excess next year larger than seventeen times that which occurs in Wales (the England/Wales population relativity) then to maintain equity I require an assurance that I would reeceive a full formula consequential increase in my following year's provision in respect of the difference.

/ I am copying this letter to Patrick Jenkin, other members of E(A), the Prime Minister and Sir Robert Armstrong.

Yours sincerely

Approved by the Secretary of State
and signed in his absence