

CCBG



2 MARSHAM STREET  
LONDON SW1P 3EB  
01-212 3434

My ref:

Your ref:

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NSP7 at this stage

D. M. M.

## LOCAL AUTHORITY CAPITAL EXPENDITURE CONTROLS

At E(LF)(85)4th meeting, item 1, I was asked to discuss further with you the implications for a reformed system of capital expenditure control of the assurances given in the past to local authorities about use of capital receipts.

These assurances were given to reassure supporters during the debates about reducing the prescribed proportion of capital receipts which authorities may use in any one year for additional capital expenditure. For example, Patrick Jenkin said in an emergency debate on 19 December last year:

"The receipts are and will remain the property of local authorities. They can spend them in future years, but the Government must ensure that the pace at which they are spent is compatible with the Government's spending plans ..." (Col 308).

In interpreting this assurance, we have to decide 4 key points:

- i. in relation to receipts accumulated under the present system, do we take the assurance as referring to the £6bn or so of notional spending power or to the £3bn or so which is still backed up by cash?
- ii. do we give similar assurances that 100% use of receipts will be allowed under the new system?
- iii. do we deny ourselves, as under the present system, the opportunity to cut allocations for authorities flush with receipts?
- iv. do we preserve the freedom of authorities to vire spending power (receipts and allocations) between services?

On (i), the difference between the £6bn and £3bn is accounted for by local authorities' freedom to use capital receipts for such purposes as redeeming debt and "capitalisation" of housing and repair and maintenance. This does not count as the use of their capital spending power, which still remains in theory even when the cash has been used.

It seems to me that the natural interpretation of past assurances relates to the cash, the £3bn or so, although we have not hitherto made much in public of the difference between the two figures. If we use the cash figure, this has the advantage, illustrated at table 1 of the Annex below, that it would enable us to allow authorities to spend receipts accumulated under the present system in full over the first 3



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ars of the new system. This allows us more scope to increase that part of the allocation distributed in accordance with need. We could however also allow full use of the £6bn (see illustration 2) though at the cost of extending the transitional period to 5 years and of having lower allocations based on need. My preference would be to stick with the cash figure. I should welcome your views.

On (ii) I propose that we should not give similar assurances in relation to receipts gained under that new system. It was never part of our original intention, even with the present system, that individual authorities would necessarily be able to use the whole of their receipts over time. By allowing them to use only a prescribed proportion, we can again redistribute the rest in accordance with need. Clearly this is a tricky point in relation to our supporters, which we should discuss.

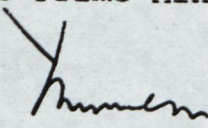
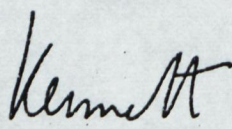
On point (iii), even where we have some information about an individual authority's receipts, we may not reduce allocations to offset spending power from receipts. Going back on the present legal position would clearly be politically awkward, but if we concluded under ii that we had to give another comprehensive assurance, then we may need to come back to this alternative approach to receipts.

On all three of these points, we do not need to take a decision now. I suggest that we keep our options open in the Green Paper. We can then review the position in the light of the Parliamentary and other reactions to it. I should emphasise one point. The estimates and assumptions in the attached paper by officials are very broad-brush and are provided for illustrative purposes only. They do no more than demonstrate that it is feasible to run a new system without abandoning past undertakings, provided that gross public expenditure provision is set at a reasonable level.

On the final point, iv, however, I think it is important to offer some reassurance in the Green Paper itself. Authorities at present enjoy the flexibility to vire spending resources between and within service blocks. When we introduced the present system we rightly gave heavy emphasis to this freedom. We would be open to fierce criticism if we restricted that right under a new system. It would reduce local accountability and open the way to wasteful expenditure. Nor in my view is such a restriction necessary. Under the present system annual expenditure on each service block almost invariably exceeds the year's allocation for that block. In other words, authorities are paying attention to our national priorities as expressed in allocations, but they are using the power of virement in relation to receipts. I propose that the Green Paper indicate that full freedom of virement will be retained.

I should welcome an early opportunity to discuss these points with you in advance of the meeting of E(LF) on 12 December to discuss the draft Green Paper text.

I am copying this letter to the Prime Minister and members of E(LF), and to Sir Robert Armstrong.

  
KENNETH BAKER 

The Rt Hon John Wakeham MP



## LOCAL AUTHORITY CAPITAL CONTROLS: TRANSITIONAL ARRANGEMENTS FOR ACCUMULATED RECEIPTS

### Introduction

1. This annex illustrates how transitional arrangements for a new gross expenditure option could allow past assurances about the use of accumulated receipts to be met whilst still allowing Ministers to allocate more on the basis of need than under the present system. It is couched in terms of the proposals for a fully gross option discussed at E(LF)(84)4th meeting, but the arrangements discussed could be adapted to the alternative option put forward by the Secretary of State for Wales.

### Allocations under the new system

2. Allocations under the new system would have three components: "old system" receipts, that is accumulated receipts at the end of the present system; "new system" receipts, that is receipts generated after the start of the new system; and the Government assessment of spending need. The total of allocations would be related to and constrained by PESC provision and therefore the more emphasis placed on any one of these elements, the less there would be available for the other two.

3. "New System" receipts would be subject to a prescribed proportion, say for example 50%. This prescribed proportion would be allowed to be spent in three equal slices in the three years after the receipt was generated. Therefore if a receipt of 90 was generated in year 1, the authority would not be allowed to spend any of it in year 1 but would receive allocations of 15 ( $90 \times 50\% \div 3$ ) in each of years 2, 3 and 4. It would therefore only be in year 4 of the new system when the authority had generated three years worth of "new system" receipts, that the "new system" receipts element of the allocations would reach its full long term level. This provides a window in the first three years of the system which could be used to allow the "old system" receipts to be spent without the allocations on the basis of need being affected too severely.



#### Definition of "old system" receipts

4. We estimate that accumulated receipts spending permission at the start of 1986/87 will be £6.3 billion. But possibly only about £3 billion of this is backed by cash. The remainder has been used to repay debt or fund non prescribed expenditure, neither of which extinguishes the spending permission attached to the receipt. Both these estimates, and in particular the cash figure, are extremely tentative. We are taking steps to collect firm information on receipts from local authorities and much better estimates of both figures should be available in the Spring before the Government has to firm up its proposals on the detail of the new system.

5. The assurances can be read in terms of either the spending permission or the cash receipts. A natural interpretation would be to relate them to the cash figure - the £3 billion, even though the assurances were given in the context of estimates of receipts of "over £5 billion", the then current estimate of spending permission.

#### Illustrations of transitional arrangements

6. The detailed transitional arrangements will depend on aspects of the new system which have not yet been decided. For the purpose of the present illustration only, the following broad assumptions have been made:

- (i) gross provision and new receipts remain at 1986/87 levels;



- (ii) there is no non-prescribed expenditure under the new system;
- (iii) "new system" receipts are subject to a prescribed proportion of 50% and have to be spent in three equal slices in the three years after they are generated;
- (iv) present level of revenue contributions (£500m) is deducted from spending power before setting allocations; and
- (v) 85% use of spending power assumed each year.

7. Gross provision each year would then be £4.35 billion. Spending power compatible with this would be £5100m ( $£4.35m \div 0.85$ ). From this would be subtracted £500m for revenue contributions, leaving £4600m available for allocations. Within this total the element for new system receipts (which are assumed to be £1.95 billion a year) would be 0 in year 1, £325m in year 2 ( $1950 \times 0.5 \times \frac{1}{3}$ ), £650m in year 3 ( $1950 \times 0.5 \times \frac{2}{3}$ ) and £975m in year 4 and later years ( $1950 \times 0.5$ ).

8. The remaining distribution between allocations on the basis of need and "old system" receipts would depend on how much of the "old system" receipts are allowed to be spent and over what period. The following two illustrations allow £3 billion (roughly equivalent to the cash receipts) to be spent over 3 years and £6 billion (roughly equivalent to the spending permission) over 5 years respectively. With advance notice, authorities should be able to use the spending power over these periods so far as they wish to do so. They should therefore not have good grounds for protesting at the imposition of the eventual 'cut-off' date.



ILLUSTRATION 1

<u>Year</u>	1	2	3	4 and later
Total allocations	4600	4600	4600	4600
less:				
"New System" receipts	0	325	650	975
"Old System" receipts	1325	1000	675	-
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allocations on basis of need	3275	3275	3275	3625

ILLUSTRATION 2

<u>Year</u>	1	2	3	4	5	6 and later
Total allocations	4600	4600	4600	4600	4600	4600
less:						
"New System" receipts	0	325	650	975	975	975
"Old System" receipts	1785	1460	1135	810	810	-
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allocations on basis of need	2815	2815	2815	2815	2815	3625



