chex.jp/ds1/45 **CONFIDENTIAL**

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Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

8 February 1990

Rt Hon Christopher Patten MP
Secretary of State for the
Environment
Department of the Environment
2 Marsham Street
LONDON
SW1P 3EB

Dear Secretary of State,

PWLB QUOTAS FOR 1990-91

As you may be aware, I have become increasingly concerned about the level of local authority investments. These, coupled with high levels of borrowing from the PWLB, are now causing unacceptable difficulty for our management of the money market. This poses a threat to the Bank of England's control of short term interest rates - which we simply could not allow to happen. It is clear that, if present trends continue, we are going to have to start adopting increasingly difficult and expensive measures to offset the effect of local authorities' position in the market. I have, therefore, come to the conclusion that we must take more direct and immediate action.

I am aware that there are arguments that the problem will resolve itself if we wait long enough, that the level of deposits will fall as the new capital finance constraints start to bite and the level of capital receipts starts to dry up. But we cannot be certain that that will happen or how long it will take, and I am afraid I am simply not prepared to take the risk. My legal advice is that if we are to act, we should do so before the start of the coming financial year, and that if we do not, a decision to act during the course of the year may be difficult to defend if it were to be challenged in judicial review proceedings.

The most obvious solution would be to require local authorities to use their deposits to repay debt. Nigel Lawson and I considered that with your predecessor in the Summer and were eventually persuaded (very reluctantly) not to press it. We do not, therefore, have the necessary powers to tackle the problem in the most direct way. We may need to return to that route at some stage, but in the meantime our officials have been considering a range of alternative solutions. The most straightforward one appears to be to use the PWLB quota system to cut the level of borrowing from the public sector. PWLB money cannot be borrowed to invest, and there is no suggestion that that is what authorities in general are doing. But it is the combined effects of the high level of deposits and the level of PWLB borrowing which is causing the problem, and if we cannot tackle the former we must address the latter.

At present, the PWLB quota system, though still in place, does not bite. Quotas are set each year at the higher of £10 million or 75 per cent of net reckonable capital expenditure plus 10 per cent of capital debt outstanding at the start of the financial year. But for a number of years, we have encouraged the PWLB to make additional loans readily available and kept the rates at extremely competitive levels, because conditions were such that it helped our management of the markets to have local authorities' borrowing effectively channelled through the central Government accounts. That is no longer the position. Indeed the reverse is now true, and it is not sensible to compound our problems by allowing the PWLB to lend without limit, or to keep undercutting the market by such a wide margin.

Subject to any comments you have, therefore, I propose to invite the PWLB Commissioners to set the quotas for 1990-91 at 75 per cent of net reckonable expenditure plus 4 per cent of capital debt less deposits at the start of the financial year, to abolish the £10 million quota; and not to lend above quota except at penal rates or where it would otherwise cause authorities unreasonable difficulty, for example, where the authority has an exceptional pattern of debt redemption and where an authority does not have deposits which it could use instead.

Our officials have looked at the possible effect on individual authorities, so far as that can be judged with the information available. The impact will inevitably be fairly arbitrary; it will hit some authorities harder than others. But the authorities affected will be able to get the balance of their requirements on the market, albeit at a slightly higher cost. The extra cost will be unwelcome, but will only relate to the balance of their requirements, and I see no alternative. The PWLB Commissioners will be able to use their discretion to ease any particular difficulties. They will also continue to act as lender of last resort, and so no authority will be unable to raise the money it needs, one way or another.

The full impact of the proposals is difficult to assess accurately. If we had applied them in 1989-90, they would have reduced maximum entitlement by a nominal £7.6 billion. But there is so much slack in the system at present, that actual borrowing would have been cut by far less, perhaps £2 to 3 billion. That has to be looked at against the fact that authorities currently hold investments of about £10.9 billion, about four times the level in 1985.

... I attach a draft of the proposed PWLB circular telling local authorities of the change. As you will see, it includes measures to contain the level of borrowing in the last few weeks of the year to prevent forestalling. This is perhaps the most difficult part of the package but I see no alternative, and I would be content for the Commissioners to use their discretion fairly generously on this point to avoid undue problems.

We will keep the impact of these proposals under review throughout the year, and we can ease them off very readily at any stage if circumstances permit. On the other hand, I think we must warn the authorities that if the problems persist or get worse, we may have to take further action during the course of the year.

Finally, I also propose to bring the PWLB rates up closer to, but still below, market rates when circumstances permit. The rates are currently set at the absolute minimum possible consistent with the constraints of the 1968 National Loans Act to attract as much of local authorities' borrowing as possible to the PWLB. That is no longer desirable, and I therefore propose to bring the rates closer to market levels, by holding them steady when interest rates generally start to fall. Authorities can have no legitimate expectation that interest rates will fall at any particular time in the year; if we warn them in advance, they can have no legitimate basis for complaining if the PWLB rates take longer than others to fall, and no basis for arguing that we have imposed an unexpected cost.

Authorities are already aware that we are concerned about the level of their deposits and have a good idea that we are considering taking action of some sort. But we need to tell them quickly what we propose. The PWLB usually give authorities an indication of the quotas for the year ahead in February, followed by a further detailed circular at the end of March. Unless you have any over-riding objections, therefore I will invite the PWLB Commissioners to issue a circular on the lines of the attached next Thursday afternoon (the 15th).

The Commissioners have their next meeting on Wednesday and I understand there is a meeting of the Capital Programme Working Party with the local authorities on Thursday. Given the nature of the changes, I think it would also be appropriate to announce them to the House, by way of a written PQ, for answer after Prime Minister's questions on Thursday. That written Answer would also include the interest rate change outlined above. (The interest rates are set by the Treasury not the PWLB Commissioners). My officials would clear the text with yours.

Could you and copy recipients please let me know that you are content **by next Thursday morning at the latest**. I would be happy to discuss, if you wish. I am copying this letter to the Prime Minister, Malcolm Rifkind, Peter Walker, and the Governor.

Yours sincerely.

Duncan Sparkes

p.p. **JOHN MAJOR**

[Approved by the Chancellor and signed on his behalf]

CONFIDENTIAL

DRAFT PWLB CIRCULAR TO LOCAL AUTHORITIES

QUOTA ARRANGEMENTS FOR 1990-91

1. As foreshadowed in the Board's Circular No. 86 issued on 8 February 1989, the Commissioners have reviewed the quota arrangements for the financial year 1990-91 and have decided that the following changes will be made.

2. The quota entitlement for each authority will be:

75 per cent of its net reckonable capital payments made during 1990-91; plus

4 per cent of its net reckonable debt incurred for capital purposes, being the total amount outstanding less the total of sums held on deposit on 31 March 1990.

There will be no minimum quota entitlement.

3. The Commissioners will no longer be prepared, as a matter of course, to make loans available in addition to the quota and at quota rates. The normal arrangements by which loans may be made under the non-quota A and non-quota B facilities will continue to operate.

4. In order to limit the level of borrowing in the remainder of this financial year, the Commissioners have decided to restrict advances from the date of this circular to 31 March 1990, to not more than one-tenth of each authority's quota for the year.

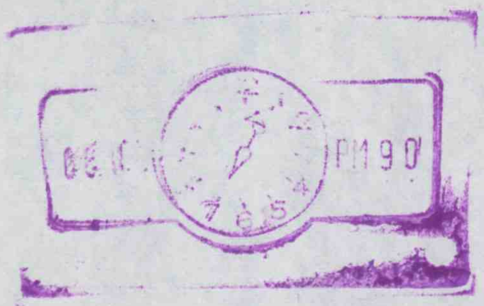
5. The limits on carry-over of 1989-90 quotas into 1990-91 will remain as stated in section 5 of the Board's Circular No. 87, issued on 28 March 1989. The Commissioners intent to set a lower limit for carry-over from 1990-91 into 1991-92.

6. The Commissioners will be prepared to consider particular instances of exceptional difficulty or hardship arising from the

foregoing changes and to make special provision if they deem it appropriate.

7. The new arrangements will be kept under review during the year.

8. A circular giving full details of the arrangements for lending to local authorities from 1 April 1990 will be issued in March. Enquiries relating to this circular may be made to ......



PRIME MINISTER

MONEY MARKET MANAGEMENT: PWLB QUOTAS AND RATES

You will wish to be aware of some Treasury proposals for amending the terms of PWLB lending to local authorities. This arises because local authorities have been causing great difficulties for money market management by borrowing long term from the PWLB at the very fine rates available and then building up short-term deposits.

The Treasury letter setting out their proposals at Flag A is very difficult to follow, and you may prefer just to rely on the attached one page summary describing both the problem and the proposals.

all the big spenders!

The package is supported by the Governor (Flag B), but a number of caveats have been raised by Chris Patten (Flag C), Malcolm Rifkind (Flag D) and Peter Walker (Flag E). Chris Patten's letter at Flag C is the most significant, drawing attention to the presentational problems in appearing to put an extra burden on local authorities - by effectively raising their borrowing costs - just when community charge levels are being set. But I gather that the Treasury consider that they can satisfactorily meet Chris Patten's points in the drafting of the proposed statement. If they can't borrow so easily - they won't spend so easily.

Content to note the Chancellor's proposals and agree to him proceeding subject to sorting out with colleagues the detailed points they have raised?

Yes - moreover (but not just now) perhaps we might consider why we have a PWLB at all - when we are constantly arguing that 2-tier interest rates don't work because they leak. MT

PRCG.

PAUL GRAY

14 February 1990

c:\wpdocs\economic\pwlb.eam

MONEY MARKET MANAGEMENT: PWLB QUOTAS AND RATES

The Problem

The Bank controls interest rates by keeping the money market short of funds. It is becoming increasingly difficult to maintain shortages because local authorities are borrowing long from the PWLB at very fine rates and building up substantial short-term deposits at much higher interest rates, a profitable but risky exercise.

The Proposal

The right solution would be to require local authorities to use deposits to repay their debt. But the Treasury was unable to get the necessary clauses into the Local Government and Housing Bill last summer.

Instead, the Treasury is now proposing:

- tightening up PWLB "quotas" (the limits that apply to each local authorities' access to PWLB funds at fine rates) and ensuring quotas take into account the level of a local authority's deposits;

- bringing PWLB lending rates for quota borrowing closer to (but still below) market rates when circumstances permit;

- asking the PWLB to stop lending above quotas except at penal rates or where a local authority might experience difficulty.

The Effect

These measures will not halt local authority financial intermediation. But they should cut the level of local authority borrowing from central Government and thus significantly ease the money market situation.

CONFIDENTIAL

File
to Al

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

15 February 1990

Dear Duncan,

PWLB QUOTAS FOR 1990-91

The Prime Minister has seen the Chancellor's letter of 8 February to the Secretary of State for the Environment and the subsequent comments from the Secretaries of State for the Environment, Scotland and Wales and the Governor of the Bank of England. The Prime Minister is content for the Chancellor to proceed with the proposed changes.

I am copying this letter to Roger Bright (Department of the Environment), Jim Gallagher (Scottish Office), Stephen Williams (Welsh Office) and to Paul Tucker (Bank of England).

Yours,
Paul

PAUL GRAY

Duncan Sparkes Esq
HM Treasury

CONFIDENTIAL

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c: PWLB

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

15 February 1990

PWLB AND MONEY MARKET MANAGEMENT

I have written separately to you, copying to other Departments and the Bank of England, about the Prime Minister's main reaction to the recent papers on PWLB quotas for 1990-91. The Prime Minister has also commented, however, that she wonders whether consideration should be given to whether it is necessary now to retain an organisation like the PWLB at all. She would welcome the Chancellor's views on this.

BF

I am copying this letter to Paul Tucker (Bank of England).

PAUL GRAY

Duncan Sparkes Esq
HM Treasury

SECRET

Cile DAS

MR MILLS

PWLB QUOTAS FOR 1990/91

Thank you for your note of today's date. I must say I have serious doubts about putting your ideas to the Prime Minister. At this morning's meeting, having flirted with the idea of limits on local authorities' expenditure, the Prime Minister was coming back to the view that Community Charge capping was the right approach. To suggest that capping should now be linked to the RPI is surely far too draconian to be contemplated. It cannot be justified by analogy with the NNDR; the two cases are quite different given the uniform nature of the new business rating system. Your idea would drive a coach and horses through the concept of accountability.

Equally, I do not see how Ministers could contemplate saying that the Community Charge could only be used for revenue purposes. We have only just put in place a whole new capital régime for local authorities, and this too would be effectively torn up.

So, unless you have any evidence that DoE Ministers themselves are contemplating ideas of this sort, I really do not think it is right to be floating your radical suggestions at this stage.

As to the handling of the PWLB quotas correspondence, I have been waiting to see a response from the DoE before alerting the Prime Minister. But I am told that should be available tomorrow.

PRCG.

PAUL GRAY

13 February 1990

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RA

PAUL GRAY 13 February 1990

PWLB QUOTAS FOR 1990/91

with PG?

The Chancellor's letter of 8 February to Chris Patten.

The essence of the problem which the Chancellor wishes to tackle is that local authorities are financing capital expenditure through cheap borrowing from the PWLB, rather than from their substantial holdings of receipts which they are lending on the money markets for better returns, or from the money markets themselves. The size of the flows is such that it is impacting upon the Bank's control of short-term interest rates.

The Treasury's aim is to reduce money market distortions, not to cut local authority borrowing. But a secondary, important objective, is to wean authorities away from borrowing at preferential interest rates. PWLB rates are typically ¾% below market rates. Thus total borrowing may be reduced.

Using the PWLB had its value when authorities had few capital receipts of their own. It was a way of passing on to them the benefits of the Government's being able to borrow relatively cheaply. But now that authorities generally have high capital receipts of their own, PWLB loans are little more than a disguised subsidy from the taxpayer. Authorities in fact now have some £11 billion on deposit, four times the 1985 figure.

The Impact of the Change on Local Authorities

This will be marginal in 1990/91. But in 1991/2, as a result of tighter PWLB quotas in 90/91, a broad estimate is that £2-3 billion of local authority borrowing will be switched from the PWLB to the markets. This will carry a relatively higher interest burden. In addition, reducing the differential between PWLB and market interest rates will lead to a relative increase in the costs of PWLB borrowing.

There is thus likely to be some impact upon 1991/2 Community Charge levels. DOE have tentatively estimated that 1991/2 average charges could be some £14-16 higher than otherwise.

Policy Implications

The possible impact on 1991 average community charge needs to be taken very seriously. It is not, in my view, an argument for not supporting the Chancellor. But, especially in the light of the Prime Minister's meeting today, it does beg the question whether action needs to be taken to control local authorities' financing of capital from revenue.

The new arrangements for local authority finance do not tackle this directly, but rely on the inherent discipline of the Community Charge. The evidence from Hampshire, for example, described today by Chris Patten, is not however very encouraging that this will work. It would be particularly unfortunate if, next year, a number of authorities continued to seek to raise capital through the Community Charge and were able to claim justification, in whole or part, by reference to the policy changes now proposed by the Chancellor.

Even apart from the current proposal, the situation described this morning was serious enough to warrant consideration being given now to possible ways of ensuring that community charge can only be used for revenue purposes except (perhaps) where a specific local electoral mandate to the contrary had been obtained. It may even be that such controls would need to go hand in hand with more direct restrictions on maximum charge levels, for example by limiting future increases to the rate of inflation, as with NNDR, though one recognises that this could create difficult problems of accountability.

CONCLUSION AND RECOMMENDATIONS

I understand that other colleagues are likely to support the Chancellor's proposal: it has been extensively discussed at official level. It is clearly a necessary step in terms of economic management. But it does run the risk of fuelling the tendency which has already emerged from local authorities to seek to use the community charge for capital as well as revenue purposes. This carries considerable dangers for charge levels in 1991 and beyond.

I therefore recommend that in endorsing the Chancellor's proposal, the Prime Minister asks for work to be put in hand on the possibility of averting this, for example through new rules which would limit the use of community charge moneys for revenue purposes. This work might also include the feasibility of limiting future increases in Community Charge to the rate of inflation, as with NNDR.

John Mills

JOHN MILLS

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Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

14 February 1990

Rt Hon Christopher Patten MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
LONDON
SW1P 3EB

Dear Secretary of State,

PWLB QUOTAS

Thank you for your letter of 13 February.

I am, of course, only too conscious of the presentational difficulties of the changes outlined in my letter of 8 February, but am pleased that you agree to the general principles of them.

On your specific points, the effect in 1990-91 should, as I said in my letter, be minimal, and I am pleased to have your confirmation of that. I have some difficulty with the argument that there will be a cost when interest rates fall. Authorities will save less than they might otherwise have done, but we will not have added to their costs. And PWLB rates will still be below market rates.

Nevertheless, to the extent that higher costs may arise in 1991-92, this will be a relevant factor in our negotiations on the local authority settlement for that year. But I think we should stick to the principle that Government imposed additions to local authorities' costs should be reflected in Total Standard Spending numbers; how far these costs should be met by the taxpayer through Aggregate External Finance or by the charge payer should be determined when the decisions on the settlement are taken. We should say no more publicly, at this stage, than that "any higher costs will be relevant to the local authority settlement", but only if asked, and I would prefer not to include it in my written answer.

I have not invited the PWLB Commissioners to include the reference to abnormal amounts of debt maturing in their circular. As your officials are aware, Treasury Solicitor's firm legal advice is that it is unwise for the Commissioners to try to spell out in their circular the particular factors they may take into consideration in dealing with special cases, since that might actually limit their freedom to deal with all the circumstances of a particular case and deal with it on merits. I am, however, able to make the point in the written answer which I will give to the House and will do so, although the wording has to be very carefully chosen.

Our officials have already discussed the possibility of defining the quota in terms of an authority's credit ceiling. I can see some force in the point, but there is no direct equivalent in Scotland. If the English authorities themselves raise this point, however, and if some alternative formula can be devised that the Scottish authorities accept as equivalent and fair, then I will consider inviting the Commissioners to adopt that alternative at an appropriate time. In the meantime, however, I think it is sensible to stick to the tighter, consistent formula.

The Commissioners considered and agreed the proposed changes at their meeting this afternoon and they will notify the authorities tomorrow afternoon as planned. I attach the final version of their circular and a copy of my proposed written answer, which your officials have already seen in draft.

I am copying this to the Prime Minister, Peter Walker, Malcolm Rifkind and the Governor.

Yours sincerely.

Duncan Sparkes

p.p. JOHN MAJOR

[Approved by the Chancellor and signed on his behalf]

noble/12.2/dr.pq

DRAFT PQ

To ask Mr Chancellor of the Exchequer what will be the arrangements for lending to local authorities by the Public Works Loan Board in the forthcoming financial year.

DRAFT REPLY

Every year the PWLB Commissioners, after consultation with the Treasury, determine loan quotas for each authority. Borrowing within these quotas is at very fine rates set by the Treasury. Additional loans may be made in specific circumstances at higher ("non quota A" and "non quota B") rates.

In recent years the Commissioners have, however, as a matter of course, made advances additional to the normal quotas available at quota rates. This was done with the agreement of the Treasury in order to assist in the management of the money markets. At present, however, local authorities are, in total, investing very substantial sums of money with the banking sector, whilst at the same time borrowing large sums from the PWLB. The combined effect of this is to cause difficulties in the management of the money markets. The Government therefore believes it is now desirable to curtail the availability of funds from the PWLB at quota rates.

The PWLB Commissioners have reviewed the quota arrangements for the financial year 1990-91 and have today issued a circular (number 89) indicating that the quota entitlement for each authority will be:

75 per cent of its net reckonable capital payments made during 1990-91; plus

4 per cent of its net reckonable debt incurred for capital purposes, being the total amount outstanding less the total sums held in financial investments on 31 March 1990.

There will be no minimum quota entitlement. The normal arrangements by which loans may be made under the non quota A and non quota B facilities will, however, continue to operate. Local authorities' ability to borrow in the market will not be affected.

With effect from today the Commissioners will no longer be prepared, as a matter of course, to make loans available in addition to the quota and at quota rates.

In order to limit the level of borrowing in the remainder of this financial year, the Commissioners have also decided to restrict advances within quota from the date of the circular to 31 March 1990, to not more than one tenth of each authority's quota for the current financial year.

The Commissioners will be prepared to consider requests from local authorities for advances additional to normal quotas at quota rates where the changes listed above will cause an authority exceptional difficulties, for example where it faces unusually high levels of maturing debt. The decision will be for the Commissioners, but I understand that, in deciding whether to make an advance, they will take into consideration, along with other factors, the level of the authority's investments and that the Commissioners are unlikely to be prepared to agree to an advance if, and to the extent that, it appears to them that these investments could be used instead.

An authority wishing to borrow from the Board in addition to quota may also apply for non quota B loans. The Commissioners will continue to be prepared to consider applications for such advances where it can be demonstrated that additional capital finance is needed in the relatively near future. The rate of interest on non quota B loans is currently 1 per cent above non quota A loans. From 1 April 1990 I have decided that the rate of interest on non quota B loans will be 2 per cent above the rate of interest on quota loans.

At present the interest rate on quota loans is set at the lowest possible level consistent with the constraints of the 1968 National Loans Act. I have decided that for the future this fine rate will no longer be appropriate. Quota rates will therefore be gradually increased so that they are closer to, but still below, market rates. This will be done by maintaining PWLB rates when general interest rates fall.

01 606 3766

PUBLIC WORKS LOAN BOARD

National Investment and Loans Office
Royex House Aldermanbury Square London EC2V 7LR

Telephone
01-606 7321

CIRCULAR NO. 89

To the Chief Financial Officer
of local authorities in
England, Wales and Scotland

15 February 1990

QUOTA ARRANGEMENTS FOR 1990-91

1. As foreshadowed in their Circular No. 86 issued on 8 February 1989, the Public Works Loan Commissioners have reviewed the quota arrangements for the financial year 1990-91 and have decided that the following changes will be made

2. The quota entitlement for each authority will be:

   75 per cent of its net reckonable capital payments made during 1990-91; plus

   4 per cent of its net reckonable debt incurred for capital purposes, being the total amount outstanding less the total sum held in financial investments on 31 March 1990.

   There will be no minimum quota entitlement. The normal arrangements by which loans may be made under the non-quota A and non-quota B facilities will continue to operate.

3. With effect from the date of this circular, the Commissioners will no longer be prepared, as a matter of course, to make loans available in addition to the quota and at quota rates.

4. In order to limit the level of borrowing in the remainder of this financial year, the Commissioners have also decided to restrict advances within quota, from the date of this circular to 31 March 1990, to not more than one-tenth of each authority's quota for the year.

5. The limits on carry-over of 1989-90 quotas into 1990-91 will remain as stated in section 5 of the Board's Circular No. 87, issued on 28 March 1989. The Commissioners intend to set a lower limit for carry-over from 1990-91 into 1991-92.

6. The Commissioners will be prepared to consider particular instances of exceptional difficulty or hardship arising from the foregoing changes and to make special provision if they deem it appropriate. In exercising this discretion the Commissioners will, if necessary, take into account any differences in the capital expenditure control arrangements and budgetary timetable of Scottish authorities and those in England and Wales.

7. The new arrangements will be kept under review during the year.

8. A circular giving full details of the arrangements for lending to local authorities from 1 April 1990 will be issued in March. Enquiries relating to this circular may be made to 01-606 7321, extensions 23, 41 or 31.

I H Peattie
Secretary

ccP/PL

C

2 MARSHAM STREET
LONDON SW1P 3EB
01-276 3000
My ref
Your ref

The Rt Hon John Major MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

13 February 1990

Dear Chancellor

WITH PC?

Thank you for your letter ~~of 8~~ February about Public Works Loans Board Quotas for 1990-91.

I can understand your general approach. I agree that we should address this problem at source rather than seek to prescribe how local authorities should use their deposits. But I have three concerns.

First, there are serious presentational problems. Your proposals represent unavoidable additional burdens on local government just at the season when community charges are being set and when our opponents are seeking excuses to put the blame for the level of charges on our shoulders. As deposits are run down, local authorities will lose the benefit of the "turn" between the interest receivable on their deposits and the interest payable on PWLB loans. And when PWLB quota rates are adjusted more into line with market rates, authorities will have to pay the higher rates on new loans. Whilst you are right to say that local authorities have no expectation of any particular level of interest rates, they have had the expectation that PWLB rates would be somewhat finer than market rates, whatever these turned out to be.

The effects of your proposals would be small in 1990-91. For 1991-92 and later years they would be noticeable. I seek your confirmation that costs will be fully allowed for when we set Total Standard Spending (TSS) and Aggregate External Finance for 1991-92 and we should state this explicitly when the changes are announced.

Secondly, the proposals could have serious consequences for individual authorities with an abnormal amount of debt maturing in 1990-91. I understand that it is your intention that the Commissioners would be able to use their discretion to lend at quota rates in excess of quotas to assist such authorities. I believe that it would be right to make this explicit. I suggest adding

"They will, however, consider applications from local authorities with an abnormally high level of debt due to mature in the financial year."

after the first sentence of paragraph 3 of the draft circular. The word "also" should then be added after "The Commissioners will" in paragraph 6.

Thirdly, your proposals would work harshly in the case of authorities which, for whatever reason, have an abnormally high level of revenue balances or usable capital receipts at the beginning of 1990-91. These will in general be the authorities who have resisted the temptation to spend as much as possible of their receipts this year. This disadvantage of your proposals could readily be removed by redefining for local authorities in England and Wales the second element of the quota entitlement as:-

"4 percent of its credit ceiling on 1 April 1990"

In the new capital finance system, the credit ceiling is the measure of an authority's credit liabilities which have not been provided for and is independent of revenue balances and usable receipts (though it incorporates the receipts set aside for debt redemption at the start of the new system).

I am sending copies of this letter to the Prime Minister, Peter Walker, Malcolm Rifkind, and the Governor of the Bank of England.

Yours sincerely

R Bright

CHRIS PATTEN

PP

(approved by the Secretary of State and signed in his absence)

13.02. PM 90

Copy to The Rt Hon Margaret Thatcher MP
Prime Minister

B

CCPM

The Governor

Bank of England
London EC2R 8AH

14 February 1990

The Rt Hon John Major MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London
SW1G 3AG

Dear John,

PWLB QUOTAS FOR 1990-91

WITH PG

In your letter ~~of 8 February~~ to the Secretary of State for the Environment, you asked copy recipients to let you know whether they are content with what you propose. The Bank entirely supports your initiative. We think that it will be helpful in alleviating the problems that have recently arisen for money market management, particularly if above-quota lending, even at penal rates, is withheld (other than in exceptional circumstances) from local authorities which have large amounts of both deposits and outstanding borrowings from the PWLB.

I am copying this letter to the Prime Minister, Christopher Patten, Malcolm Rifkind and Peter Walker.

Yours ever,

Robin

CONFIDENTIAL

SECRETARY OF STATE FOR SCOTLAND

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

cc PU.

The Rt Hon John Major MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

20 February 1990

Dear John,

PWLB QUOTAS

Thank you for your letter of 14 February. I was grateful to hear that the Commissioners had decided to make reference to local authority timetables in their circular and I think that this decision and the sue of the term "financial investments" to describe "deposits", with the possibility of further clarification in the circular, remove the grounds for any unnecessary concern in Scotland about the new arrangements which you have announced.

I am copying this letter to the Prime Minister, Peter Walker, Chris Patten and the Governor of the Bank of England.

Yours,
Malcolm

MALCOLM RIFKIND

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CONFIDENTIAL

LOCAL AUTHORITY
Relations
Pt 37

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Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

14 February 1990

Rt Hon Malcolm Rifkind QC MP
Secretary of State for Scotland
Scottish Office
Dover House
Whitehall
LONDON
SW1A 2AU

Dear Secretary of State,

PWLB QUOTAS

WITH PG

Thank you for your letter of ~~13 February~~.

I am, of course, all too conscious of the presentational difficulties of the proposed changes, and they are not undertaken lightly. But as I explained in my letter I think we must act.

I note your point about the low level of deposits held by Scottish local authorities. That will, of course, be reflected in quotas, on the definition proposed.

I also note your comments on timing and the special problems in Scotland. Legally the PWLB Commissioners have complete discretion on the way they handle individual cases and I cannot direct them on what factors they should consider in taking their decisions. But they consider each case on merits and listen to any arguments an authority wishes to put forward to them. Treasury Solicitor's advice is that it is unwise for the Commissioners to try to spell out too far in their circular the particular factors which they may consider, since that might constrain their discretion unnecessarily and limit their freedom to take account of all relevant factors. Nevertheless the Commissioners have agreed to include the following sentence in the circular:

> "In exercising this discretion, the Commissioners will, if necessary, take into account any differences in the capital

expenditure control arrangements and timetable of Scottish authorities and those in England and Wales."

If a Scottish authority considers it faces particular problems because of the different system or timetable in Scotland, that is certainly an argument they are free to put to the Commissioners. The Commissioners will judge whether it causes unreasonable difficulty in the particular circumstances of the authority and act accordingly.

My officials have been in touch with yours about the term "deposits". The circular now refers to "financial investments", which I hope will be clearer. If not, the point can be further clarified in the full circular which the PWLB will issue at the end of March.

Although the timing is tight, I am satisfied that the proposed changes are necessary and can be justified. But we should not delay any further. The Commissioners met this afternoon and approved the changes, which they will notify to authorities tomorrow afternoon as planned. I attach the final version of their circular. I will announce the changes to the House with the attached written answer.

I am copying this to the Prime Minister, Peter Walker, Chris Patten and the Governor.

Yours sincerely.

Duncan Sparkes

p.p. JOHN MAJOR

[Approved by the Chancellor and signed on his behalf]

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D cc/o

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SCOTTISH OFFICE
WHITEHALL. LONDON SW1A 2AU

Rt Hon John Major MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3EB

13 February 1990

Dear John,

PWLB QUOTAS FOR 1990-91

WITH PC!

Thank you for the copy of your letter of ~~8~~ February to Chris Patten about the circular you intend writing to PWLB Commissioners to issue on Thursday (15 February).

While I have no reason to question the aims which the revised quota arrangements are intended to meet, the timing of their announcement does concern me. Scottish local authorities had to determine their community charges by 29 January and have therefore already taken their key budgetary decisions for the coming financial year. There is a risk, therefore, that either or both of the decisions to restrict access to quotas over the balance of this year and to reduce quotas for the coming year may affect particular authorities adversely and in ways in which they had not planned for. I can put it no more strongly than this since we have not been able in the limited time available to explore these questions and I doubt, even if we had been given more time, whether we could have reached a firmer view without consulting local authorities themselves which clearly would not be possible in the circumstances.

Added to this concern there is I believe a presentational point I have to bear in mind and this is that, notwithstanding the case for bringing PWLB quota interest rates closer to market rates over time, the need for precipitate action arises from the accumulation by certain English local authorities of large deposits from unused capital receipts. In Scotland our rules, which prohibit local authorities from carrying out more than 10 per cent of the value of capital receipts generated in a particular year, have prevented deposits which might be held into the medium to longer term building up from receipts.

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The difference in the budgetary cycle in Scotland may therefore cause particular transitional difficulties here and in a situation in which the need for urgent action was not attributable to financial management by Scottish local authorities. Clearly the risk of the Government being held to have acted unreasonably in this regard would be reduced if the Commissioners were able to take account of the Scottish budgetary cycle in using their discretion in relation to the restriction on the use of quotas this year as well as the effect of the reduced quotas next year. I do not know what guidance is given to the Commissioners on the use of discretion but I do not think that in practice its use in circumstances of "exceptional difficulty or hardship" would be sufficient to meet my concern. This is simply that particular Scottish local authorities may be drawn into deficit next year because they were unable to allow for the effects of the new arrangements on their budgets when setting community charges for the coming financial year. The description of the use of discretion given in paragraph 6 of the draft circular appears to me to be too restrictive to cover circumstances in which authorities have already taken decisions for the coming financial. I should therefore like you to consider adding at the end of paragraph 6 of the proposed circular the following:-

> "In exercising this discretion in respect of Scottish authorities the Commissioners will take into account the differences in the Scottish capital expenditure control arrangements and budgetary timetable."

Without such an addition I think we could face enormous difficulties in the event of judicial review.

On a minor point of definition, it is not clear what definition of "deposits" will be used in calculating the new quotas. If there was a possibility of distinguishing between deposits which were essentially held as working capital for the short term and deposits which consisted of medium to long term investment when setting quotas, I would be slightly less concerned about the extent to which the arrangements might bite next year in Scotland. However I recognise the difficulties of providing a suitable definition and therefore possibly the need to rely also on the Commissioners' judgement in deciding whether deposits, or a part of them, might be used to reduce borrowing for capital purposes.

I am copying this letter to Chris Patten, the Prime Minister, Peter Walker and to the Governor of the Bank of England.

Yours ever,

MALCOLM RIFKIND

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Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

14 February 1990

Rt Hon Peter Walker MP
Secretary of State
Welsh Office
Gwydyr House
Whitehall
LONDON
SW1A 2ER

Dear Secretary of State,

PWLB QUOTAS

Thank you for your letter of 13 February.

On your first point, the changes need not increase authorities' costs to any significant extent. The cost of the bulk of authorities' borrowing will be unaffected. When interest rates fall, authorities will not save as much as they would otherwise, but that is not quite the same as saying that their costs have increased. Nevertheless, to the extent that higher costs may arise in 1991-92, that will be a relevant factor in the negotiations in the local authority settlement for that year.

On your second point, the PWLB Commissioners legally have complete discretion on how they handle individual cases and I cannot direct them on which particular factors they should consider. But they consider each case on its merits and will listen to any arguments an authority puts to them.

I note your points on timing, but I am satisfied that the proposed changes are necessary and can be justified. We must not, however, delay any longer. The Commissioners met this afternoon and agreed the changes, which they will notify to authorities tomorrow afternoon as planned. I attach the final version of the circular. I will inform the House with the attached written answer.

...

I am copying this to the Prime Minister, Chris Patten, Malcolm Rifkind and the Governor.

Yours sincerely.
Duncan Sparkes

p.p. **JOHN MAJOR**
[Approved by the Chancellor and signed on his behalf]

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From The Secretary of State for Wales

The Rt Hon Peter Walker MBE MP

13 February 1990

Dear Chancellor,

PWLB QUOTAS FOR 1990/91

with PG?

You copied to me your letter of 8 February to Chris Patten.

Clearly there will be a cost to local government. I note your view that it will be minimal for the coming year, but I would like to leave open the possibility of examining it in future LA revenue settlements if it becomes significant. So far as the effect on individual authorities goes, it is likely that your proposals would leave all Welsh counties bar one with a quota below their credit approvals for 1990/91. I would therefore hope that a comparison between quota and credit approval could be one of the criteria for determining eligibility for the special treatment you promise in cases of hardship.

Finally, I note your legal advice that any change will have to be made by the end of the financial year. Of course authorities set their budgets rather sooner than that - 1 March is the first statutory deadline but some will already have reached their decisions. I assume your legal advice has assured you that it is not already too late to make changes.

Subject to these caveats, I am content with your proposed course of action.

I am copying this letter to the Prime Minister, Malcolm Rifkind, Chris Patten and the Governor.

Yours sincerely,

Anna Coleman.

Approved by the
Secretary of State and
signed in his absence

The Rt Hon John Major MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1P 3AG