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Treasury Chambers, Parliament Street, SW1P 3AG
071-270 3000

8 October 1990

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

- cc PS/Chief Secretary
- PS/Paymaster General
- PS/Economic Secretary
- Sir P Middleton
- Sir T Burns
- Mr Wicks
- Mr Monck
- Mr Scholar
- Mr A J C Edwards
- Mr R Wilson
- Mr Bostock
- Mr Gray
- Mr Walsh
- Mr Grice
- Mr McIntyre
- Mr Ilett
- Miss Noble
- Mr Laite
- Mrs Chaplin

Dear Secretary of State

LOCAL AUTHORITY FINANCIAL ASSETS

pat

Thank you for your letter of 8 August.

I am disappointed that you do not feel able to agree in principle that the Government should legislate to require local authorities to use their reserved receipts to repay debt within a reasonable period. I think it follows from the E(LF) decision on 22 May 1987 to require authorities to pay a proportion of receipts into a "redemption fund" that there should be some clear rules as to the way that redemption fund should actually be used. It is a pity that this point subsequently slipped from view.

That said, I recognise that there is in any event no immediate vehicle for legislation, so we need not decide the point of principle now. I do however remain concerned that the threat which local authority deposits have posed in the recent past to our ability to conduct monetary policy could return as rapidly as it departed; for example if the process of "internal lending" which you describe was reversed. And while I accept that it is difficult to say with confidence where the prudent management of working capital ceases and financial intermediation begins, I have little doubt that in aggregate local authorities' holdings of financial assets are now so high relative to past levels that a great deal of intermediation is taking place. To illustrate the point in a nutshell, local authorities' debts have risen by about one half since 1980 (from £35 billion to £52 billion), but their

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financial assets have grown from £0.3 billion to £8.2 billion over the same period, ie have multiplied nearly 30 times.

Against this background, I think we should take things forward in parallel on two fronts.

First, as you suggest, our officials should work up a voluntary Code, as an immediate line of defence. I would like this to be in place as soon as reasonably possible. I regard it, however, as definitely second best to a requirement backed by legislation.

Second, although I accept that you are not prepared to agree in principle now that legislation is desirable, I hope you can agree that it is only prudent to do some contingency planning, in case monetary policy pressures make legislation essential. I would therefore like our officials to work out together a contingency plan for legislation on the understanding that this is without prejudice to any eventual decision to legislate.

As before, I am sending copies of this letter to the Prime Minister and to the Governor of the Bank of England.

Kate Gaselkie

pp JOHN MAJOR

(approved by the Chancellor
of the Exchequer and signed
on his behalf)

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