Local authorities and the capital and money markets

This article is not concerned with the scale of local authorities' capital expenditure—a large part of which is made on behalf of the central government or to meet the requirements of government policy—but rather with how it is financed. The local authorities meet only a small part of this capital expenditure out of revenue, including special rates for capital purposes. A further small amount is financed by capital grants from the central government. The rest has to be met by borrowing—either from the central government, or from the private capital and money markets, where the local authorities play an important part.

In the early post-war years, local authorities borrowed almost wholly from the central government, through the Public Works Loan Board. From the beginning of 1953 they were allowed to borrow more freely from the private sector; and from 1955 they were generally required to rely on private sources, and not on the P.W.L.B. By 1963, however, the proportion of their market borrowing which was at very short term was giving rise to official concern, and in 1964 the authorities were again given access, though on a limited scale, to the P.W.L.B. Since 1955, therefore, a number of important markets in which local authorities borrow have been developed, mostly in London; these are now being used on a large scale.

Local authorities are at present borrowing from the market in four main ways: by issues of stock, on mortgage (or ' over the counter' bond), by marketable (or negotiable) bond, and by taking temporary loans. Table I gives estimates of the amounts outstanding at 31st March 1966 on each of these forms of debt and on loans from the P.W.L.B., and of the net amounts raised during the preceding twelve months.[1]

In this article each type of borrowing is considered separately, but the relationship of one form of debt to another emerges from a discussion of general developments over the last two years. The extent to which local authorities have drawn on overseas funds is also examined.

Public Works Loan Board Between October 1955 and March 1964 local authorities were not permitted to borrow from the P.W.L.B. unless they could show that they were unable to raise funds on their own credit in the market, on reasonable terms. The Board was thus effectively closed to all but the smaller authorities, which had limited appeal to investors and which needed to borrow funds only on a small scale. New loans by the P.W.L.B. to these authorities, which were made at rates comparable with those at which the larger authorities could borrow in the market, were no greater than the Board's receipts from all authorities from repayments of loans which the Board had made earlier, and the total amount of debt outstanding to the P.W.L.B. remained virtually unchanged.

Towards the end of 1963 it was announced in a White Paper (Cmnd. 2162) that from the following April all local authorities would be able to obtain part of their long-term finance (defined as all borrowing for one year or more)

(1) The sources of the statistics are given at the end of this article.

Table I

Local authority borrowing

£ millions

	Change during 1965/66		Outstanding 31st March 1966	
Public Works Loan Board		+535 (+*16*%)		3,837 (*37*%)
Market:				
Stocks	+125 (+ *11*%)		1,252 (*12*%)	
Mortgages and 'over the counter' bonds, etc.[a]	+365 (+ *12*%)		3,461 (*34*%)	
Marketable bonds	+ 95 (+*164*%)		153 (*1*%)	
Temporary debt[b]	−153 (− *8*%)		1,674 (*16*%)	
Total market		+432 (+ *7*%)		6,540 (*63*%)
		+967 (+*10*%)		10,377 (*100*%)

(a) Includes local housing bonds, and also advances by local authority pension funds to parent authorities.
(b) Includes bank overdrafts and bills.

from the P.W.L.B., at a rate equal to that at which the Government themselves could borrow plus a small addition to cover the Exchequer's costs. This change was made partly to help the local authorities meet their growing need for long-term finance resulting from the increase in their capital expenditure and partly because, as noted later, the Government were concerned about the continued use of very short-term finance for long-term expenditure—and wished to limit its growth. It was intended that up to 50% of each authority's gross annual long-term borrowing requirement would eventually be met from the P.W.L.B. The quotas were related to gross, not net, borrowing, to help a number of authorities with very heavy short-term debt to carry through the necessary funding operations. The Exchequer, through the Board, was to continue to act as lender of last resort by standing ready to assist any local authority unable to obtain the balance of its requirements in the market; any loans over and above an authority's annual quota, however, would carry a higher rate of interest related to the rate at which local authorities themselves, rather than the Government, could borrow in the market.

In order to cause as little disturbance as possible to the local authorities, to the markets, and to the Exchequer, the new arrangements were to be introduced gradually. In the first year of their operation (1964/65) the authorities were allowed to draw from the Board up to 20% of their long-term requirements or £100,000 (increased from £50,000 in January 1965), whichever was the larger. For 1965/66 the figure was generally increased to 30%, or £100,000, though authorities in Scotland, Wales and the northern and north-western regions of England were allowed to obtain up to 40%. These quotas were heavily utilised; between March and June 1965 drawings from the Board totalled £174 million (almost half the amount budgeted for the whole year to March 1966), against only £33 million in the first quarter of the previous financial year. In July 1965 local authorities were required to spread the remainder of their borrowing from the Board evenly throughout the rest of the financial year; authorities which had by then already applied for more than half their year's quota were not allowed to draw any more until October.

The strong demand for P.W.L.B. loans in 1965/66 arose because the rates charged by the Board had become considerably more favourable than those which the local authorities had to pay for other forms of long-term borrowing. In the early part of 1964/65 P.W.L.B. rates for 'quota' loans, as mentioned above, had been based on the rate at which the Government themselves could borrow in the market, giving the local authorities a small benefit, of about $\frac{3}{8}$% per annum, on 5-10 year loans over market mortgages of comparable maturity. After the increase in Bank rate in November 1964, P.W.L.B. rates for quota loans remained unchanged, despite the rise in the Government's own borrowing rate and in other long-term rates, thus introducing a subsidy over and above the benefit just mentioned; this subsidy amounted to $\frac{3}{4}$% per annum in March 1965.

After April 1964 the local authorities began to turn over their 'long-term' debt more rapidly, by introducing 'yearling' bonds (described below) and by relying heavily on mortgages, or 'over the counter' bonds, with a life of one year or a little more. In consequence, new gross 'long-term' borrowing in 1965/66, and with it entitlement to P.W.L.B. funds, was greater than had been forecast. Again, in April 1965, it was assumed that authorities would increase the total of their temporary debt during the financial year 1965/66 (while leaving the percentage of their debt in this form unchanged); in fact they replaced some of their temporary debt with long-term borrowing, thus further raising their quotas. As a result, in 1965/66 a net total of no less than £535 million was drawn from the P.W.L.B., well over half of total net borrowing from all sources and considerably in excess of both the estimate in the 1963 White Paper (£300 million) and the Budget estimate of April 1965 (£360 million).

For 1966/67 the Government felt unable to follow the White Paper and to allow a further 10% increase in the proportion of long-term borrowing which could be financed through the Board. Instead, the same percentages apply as in 1965/66; and long-term borrowing has been redefined more narrowly to exclude the refinancing of debt that had been included in the previous financial year as part of an authority's long-term borrowing in the calculation of its quota. This restriction was aimed mainly at excluding from the quotas the renewal of the growing number of one-year bonds and short-dated mortgages in the market and was expected to cut back net drawings on the Board to about £400 million, phased, as in 1965/66, throughout the year. In fact the total in 1966/67 is likely to be more than this. When Bank rate was again raised to 7% in July, local authority mortgage rates rose to unprecedented levels;(1) in consequence a number of authorities were faced with the invoking of 'break' clauses in mortgages by lenders seeking higher interest rates. The new borrowing which followed gave these authorities the right to make additional drawings from the P.W.L.B. at rates which were then nearly 2% per annum below the rates at which they could borrow in the market. On balance, therefore, these authorities were paying little more—or perhaps even less—in total interest charges than formerly, but there will have been a distinct switch in borrowing, away from the market and towards the central government.

Stock issues

Larger local authorities have always raised a part of their long-term funds by public offers of stock through the stock market. They attach importance to raising money in this way; it keeps their name before the investing public and yields a considerable amount of money at a single operation. Because it is generally assumed that a local authority would not be permitted to default on its obligations, the credit rating of local authorities in the market is second only to that of the central government, and they are able to borrow at only a small margin above the rate for government stocks. Their issues are normally moderately sized by market standards. Though issues for the Greater London Council are usually a great deal larger, the average size of all issues is no more than about £10 million. In practice, no issue of less than £3 million is allowed.

The Bank of England, on behalf of H.M. Treasury, regulate the timing of new local authority issues, and the terms fixed are subject to the Bank's approval; this control is necessary to preserve orderly conditions in the gilt-edged market and to avoid the risk that too many (or too few) local authority issues may interfere with the pursuit of policy in the market for the Government's own stocks. In total, stock issues have made a useful contribution to local authority financing in recent years, even though local authorities have not been able to raise as much money in this way as they would have wished.

(1) At the end of July they ranged from $7\frac{5}{8}$% to $7\frac{3}{4}$% for the larger mortgages.

The marketability of these stocks is somewhat restricted by the modest size of most issues and the consequent narrowness of the market. They appeal mostly, therefore, to investors looking for secure long-term outlets for funds. Of £1,252 million outstanding on 31st March 1966, pension funds held £200 million, the special investment departments of the trustee savings banks £166 million, and the insurance companies probably about £225 million—these three together accounting for about half of the total. Much of the remaining half is thought to be held by individuals and private trusts.

Mortgages and ' over the counter ' bonds

Because local authorities have been unable to raise as much from the stock market as they would have wished, and because, between 1955 and 1964, they could not in general borrow from the P.W.L.B., they have obtained a large part of their long-term finance direct from the public and the institutions by means of mortgages secured formally on the revenue of the borrowing authority. Since July 1964 all authorities in England and Wales, and since January 1965 all authorities in Scotland, have had power to issue bonds as well as mortgages and many are now issuing them ' over the counter ', that is direct to lenders, in the same way as mortgages. From the point of view of the lender there is little difference between these bonds and mortgages: but for the borrower the bonds offer simpler documentation and easier administrative arrangements. Mortgages and bonds are normally held by the investor until maturity: they can be transferred but the liability to stamp duty on transfer renders this uneconomic. Premature repayment is sometimes, however, made possible by the inclusion of a ' break ' clause in the deed or certificate—which will be invoked by lenders when interest rates rise sharply.

A more realistic distinction is not between mortgages and bonds but between the two separate types of borrowing which apply to each of these instruments. First, many of the larger authorities raise considerable amounts, mostly from persons, through advertising in the national and local press or by circularising likely lenders. For administrative convenience, these loans often have a minimum subscription of £500. Usually they are for periods ranging between two and five years, and carry a rate of interest about $\frac{1}{2}$% lower than is offered to institutions for larger amounts. Considerable sums have been raised in this way; some are no doubt funds which might otherwise have been invested in national savings, but others would probably not have reached the public sector at all—but would have been placed with building societies or left on deposit with banks.

Secondly, for larger loans the local authorities rely on firms of brokers in London and elsewhere to put them in touch with lenders. Several firms engage in this business; most of them also operate in the temporary loan market, described later. These larger loans are now becoming, to an increasing extent, the residual item of local authority finance. Although, in day-to-day operations, bank overdraft facilities or temporary loans may be used to even out fluctuations in the flow of other items, the restrictions on temporary debt—to which, as noted later, authorities must conform by 1968—make permanent reliance on such short-term borrowing impossible. Because stock and marketable bond issues are regulated by the Bank, and P.W.L.B. finance by a formula, and because the smaller loans, by their nature, are unable to provide residual financing, the local authorities have to turn to the market for larger loans to balance their books. The terms and amounts of these loans are agreed individually between the lender and the local authority: amounts are not normally much less than £20,000 (£50,000 for the large authorities) and periods vary between one and seven years. In recent years, the yield offered has normally been between $\frac{1}{4}$% and 1% higher than on gilt-edged stocks of comparable maturity, and has on occasion been as high as that offered on industrial debentures.

Holdings of local authority mortgages and ' over the counter ' bonds at 31st March 1966 are shown in Table II; figures for March 1963, the earliest available date for all categories, are given in brackets alongside. The statistics distinguish neither between mortgages and bonds, nor between the smaller and the larger loans. The table shows that at both dates over a third of all outstanding loans was held by the personal sector, most of this no doubt raised direct from the public without the use of brokers. In the market for institutional loans, as in the market in local authority stocks, the

Table II

Mortgages and 'over the counter' bonds[a]

£ millions

	1966 31st March	1963 31st March
Personal sector	1,245	(957)
Trustee savings banks, special investment departments ...	581	(393)
Pension funds	349	(374)
Building societies	336	(221)
Insurance companies	200	(175)
Industrial and commercial companies	146	(141)
Overseas residents	29	(93)
Other and unallocated ...	575	(288)
	3,461	(2,642)

(a) Includes a few local housing bonds and also advances by local authority pension funds to parent authorities.

special investment departments of the trustee savings banks are important lenders, and so are insurance companies and building societies. Of the pension fund holdings of £349 million at March 1966, all but about £100 million consists of direct loans by local authority pension funds to their parent authorities, so that the importance of pension funds in the market proper is less than might appear from the table.

Marketable or negotiable bonds The practice has also grown of issuing a particular form of bond, in amounts ranging between £200,000 and £1,000,000, on the financial market. The title 'yearling bonds' has sometimes been used to describe these bonds, though they can have a life of between one and four years; they are also known as 'negotiable bonds'. The distinctive feature is that they are readily marketable, the issuing authority invariably compounding for the stamp duty on transfers. In practice, they differ little from short-dated stocks and appeal to much the same holders as do very short-dated gilt-edged securities; the discount houses are particularly important holders.

Issues have been made either through the Stock Exchange, in which case the bonds are quoted, or direct to a discount house or other institution. The terms and timing of these issues must, like those of stock issues, be agreed with the Bank.

At first, marketable bonds attracted little general attention in the market: in March 1965 the discount houses held £34 million of the £58 million then outstanding and the rest of the banking sector a further £17 million, leaving only £7 million in other hands. Towards the end of 1965, however, a consistent growth in demand began to develop which enabled considerably more issues to be brought forward in late 1965 and early 1966: this demand may well have been encouraged by the absence of a very short-dated government stock (there was none maturing between March 1966 and May 1967). The market became noticeably more active when the yield on bonds rose at one time above the rate paid for local authority temporary loans for the same term. By March 1966, of £153 million outstanding, as much as £44 million was held outside the banking sector.

Temporary borrowing Since the mid-1950's interest rates have frequently been high. Local authorities have often been reluctant to burden themselves with high rates for many years ahead and have therefore looked increasingly towards temporary borrowing—not only to even out fluctuations in their other receipts but also as a permanent part of their loan debt. There are three sources of temporary money—the temporary loan market, bank overdrafts, and bill finance.

The temporary loan market has grown into an efficient network run largely by money brokers and, more recently, by some of the larger stockbroking firms. The bigger authorities are in daily contact with one or more brokers, and money can usually be obtained on the same day simply by a telephone call as late as 2.30 p.m., though rather longer notice is more normal. The instrument of borrowing is a simple deposit receipt which normally bears stamp duty at a flat rate of 2*d*. £50,000 is the normal unit but amounts down to £5,000 are not uncommon.

The majority of these loans are repayable at either two or seven days' notice from lender or borrower, though some loans are initially for a longer period, such as three months. In practice, whatever the period of notice, the funds are often left for a considerable time.

Notice might be given by either borrower or lender to revise the rate of interest, if market rates changed, but otherwise the terms would continue unaltered. Over the last five years, rates paid for three months' money have usually varied between $\frac{1}{2}\%$ and 1% above the Treasury bill rate and have thus always been above the rate for prime bank bills, the higher return reflecting a slight loss of liquidity.

The main sources of temporary loans are shown in Table III. The predominance of banks (almost entirely the accepting houses and overseas banks in London) and of industrial and commercial companies in the temporary loan market is very clear; at March 1966 they held, respectively, about a third and a quarter of the total. The good returns available on local authority loans have enabled the banks to bid more keenly for bank deposits, both sterling and currency (see below), than they could otherwise have done. Though paying more for such deposits, the banks have none the less been able to employ the funds profitably in loans to local authorities, often for a matching term. Likewise industrial and commercial companies, which will not have been concerned by a slight loss of liquidity, have been attracted to local authority temporary money by the high yield and security offered.

Other financial institutions and the personal sector have invested less in this form of debt than in stocks and mortgages—the institutions because they tend mostly to look for longer-term outlets for their funds, and persons because this is essentially a market organised on wholesale lines and not for small amounts. The personal sector—which includes unincorporated businesses, trade unions and charitable institutions as well as private individuals—did, however, invest on a large scale in late 1964 and early 1965, when rates were bid up to very high levels because of the loss of foreign funds from the market, and when the local authorities were more willing to accept smaller amounts.

Bank overdrafts are not generally very large: most authorities look to their bankers only to even out overnight fluctuations in their cash positions and to provide a safeguard against unforeseen withdrawals of temporary money.

Table III

Temporary loans[a]

£ millions

	1966 31st March	1963 31st March
Banks	560	(325)
Industrial and commercial companies	384	(346)
Overseas residents	172	(92)
Building societies	154	(87)
Insurance companies	35	(40)
Pension funds	37	(20)
Investment and unit trusts ...	43	(17)
Trustee savings banks, special investment departments ...	17	(7)
Persons (including net errors and omissions)	208	(232)
	1,610	(1,166)

[a] These figures, unlike those in Table I, exclude bank overdrafts and bills; see the notes on sources and definitions.

The total of advances to local authorities shown in the quarterly analysis of advances made by members of the British Bankers' Association has been remarkably stable,[1] and over the past ten years has rarely fallen outside the range of £75 million to £100 million. This analysis relates to dates in the middle of February, May, August and November of each year, and advances may be rather higher at the end of a month, and particularly at the end of a calendar quarter when funds in the temporary loan market tend to be rather tight as lenders withdraw money for balance sheet purposes. This is borne out by figures for advances to local authorities by the domestic banks at the end of calendar quarters.[2] Although this series shows a rather higher level of advances outstanding than the B.B.A. figures, it does not indicate any substantial fluctuations, apart from an exceptional rise in December 1964 and in March 1965, referred to later, and a fall in June 1965.

The third form of temporary borrowing, bill finance, has not been used very much either, though it is often a comparatively cheap method. Only a few authorities have possessed the power, under local acts, to issue bills. In most cases this power was confined to bills for

[1] Table 13 of the statistical annex.

[2] Table 8 (ii) of the annex. Figures for periods before June 1965 are given in earlier issues of this *Bulletin*.

capital purposes, and could not in fact be exercised because Treasury consent, under the Control of Borrowing Order 1958, was not forthcoming. Where the power related to bills in anticipation of revenue this consent was not necessary, and some bills were issued; but only about £10 million were outstanding at any one time. The monetary authorities were opposed to any wide extension of the power to issue bills against revenue because they considered that the total short-term debt of local authorities was already growing too fast and that a large increase in the amount of bills available to the market might have had unwelcome effects on the liquidity of the system. In the last year or two, with the growth of temporary money regulated, some relaxation in the supply of bills has become tolerable, and the seeking of powers in local legislation to issue bills in anticipation of revenue is no longer opposed. Two authorities, Manchester[1] and the Greater London Council, have so far made issues under newly acquired powers, and Leeds and the London boroughs may follow.

Local authority bills are eligible for discount at the Bank by the discount market—or for security for advances by the Bank to the market—provided certain conditions are satisfied. The most important of these is that there must be at least sixty days in each financial year during which no bills are outstanding. The Control of Borrowing Order 1958 imposes another major restriction—all bills must be repayable not later than one month after the end of the authority's financial year.

Overseas funds

It is not possible to show the precise extent to which local authorities have relied on overseas funds, because much of these have reached them through intermediaries in this country. In March 1966 direct overseas holdings, so far as they can be identified, totalled £215 million; £172 million in temporary debt, £29 million in mortgages and 'over the counter' bonds, and £14 million in stocks.

Apart from these direct holdings, however, a large part of the temporary loans made by accepting houses and overseas banks in London (£556 million at 31st March) probably related to the investment by these institutions of overseas funds, held on deposit with the banks either in sterling or in foreign currency. If the deposit was in sterling the proceeds will have simply been placed, often for a matching period, with a local authority. If it was in currency it will have been switched into sterling, the bank or accepting house covering itself against the exchange risk by buying currency forward; such switching becomes profitable when short-term lending to local authorities, after taking into account the cost of forward cover, gives a higher return than would be earned by relending the deposit in the euro-currency market. In either case the short-term nature of temporary loans and the continuing changes in relative yields have meant that such funds have moved into and out of local authority loans in considerable amounts over the last couple of years, particularly during the winter of 1964-65.

If, as it seems reasonable to assume, half of all loans to local authorities by the accepting houses and overseas banks originated abroad,[2] the total of local authorities' direct or indirect external liabilities at 31st March 1966 will have amounted to around £500 million—of which temporary loans accounted for £450 million. This would mean that at that date well over one quarter of all temporary borrowing—though less than one tenth of all borrowing from the market—effectively came from overseas.

By September, however, there had been an appreciable reduction, perhaps of £75 million, in the amount borrowed from overseas sources —following the outflow of short-term overseas funds from London during the summer months, noted in the Commentary.

Restrictions on temporary borrowing

In 1955, before the virtual withdrawal of P.W.L.B. facilities forced local authorities to finance their capital expenditure by borrowing from the market, the total of temporary debt outstanding was only about £130 million, 3% of total local authority debt. By

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(1) December 1965 *Bulletin*, page 311.

(2) Of the total sterling resources available to the accepting houses and overseas banks at 31st March 1966, half originated abroad. Much the greater part of this foreign money consisted of sterling deposits; the rest consisted of foreign currency deposits with these institutions which had been switched into sterling.

1963 it had risen to over £1,200 million, or about 15%. This growing dependence on short-term financing led to the Government's review of local authorities' borrowing arrangements, mentioned earlier. The Government were concerned that the growth of local authority short-term debt, which continued despite changes in the level of interest rates, could hamper the monetary authorities in their management of other financial markets; and that switching into or out of sterling, for investment in or withdrawal from local authority temporary money, could also give rise to a substantial inflow or outflow of foreign exchange at times which might be inconvenient for the monetary authorities. As a result the Government decided to restrict each authority's temporary borrowing (defined as all borrowing initially repayable within one year) to not more than 20% of its total loan debt. However, as some authorities' temporary debt was considerably in excess of this percentage, the limit would not become operative for four years, until April 1968, though it was hoped that those authorities would steadily reduce their temporary borrowing in the meantime.

At the end of the first year of this period, in April 1965, the overall proportion of temporary debt had, in fact, risen to about 19%. The local authorities most affected by the impending limit had shown little sign of reducing their temporary debt during the year, and meanwhile other authorities, whether because of the disturbed conditions in the markets at that time, or because they wanted to bring their short-term money up to the impending limit, had increased their temporary debt. Towards the end of 1965/66, however, there was a marked reduction in the total of temporary debt outstanding and by March 1966 the proportion of debt in this form had dropped back to about 16%.

In the longer term, because the restriction takes the form of a percentage and not of an absolute total, it will not, in fact, reduce the amount of local authority short-term debt outstanding, but will merely prevent it from increasing so quickly.

Table IV

Quarterly analysis of local authority borrowing

£ millions

Quarter ended	Stocks	Mortgages, 'over the counter' bonds, etc.	Marketable bonds	Temporary loans: Accepting houses and overseas banks	Temporary loans: Other	Bank overdrafts	Total market	P.W.L.B.	Grand total
1964/65									
June ...	+ 19	+ 42	+ 2	+ 61	+ 38	−26	+136	+ 33	+169
Sept. ...	+ 3	+ 25	+36	+ 94	− 17	+21	+162	+ 32	+194
Dec. ...	+ 7	− 6	—	−124	+134	+48	+ 59	+ 93	+152
Mar. ...	+ 50	+ 94	+15	+ 81	− 17	+33	+256	+ 74	+330
	+ 79	+155	+53	+112	+138	+76	+613	+232	+845
1965/66									
June ...	+ 49	+ 37	+ 4	− 57	+ 76	−77	+ 32	+174	+206
Sept. ...	+ 17	+113	+15	+ 15	+ 29	+ 1	+190	+ 68	+258
Dec. ...	+ 25	+112	+41	+ 68	−132	−10	+104	+117	+221
Mar. ...	+ 34	+103	+35	− 9	− 69	+12	+106	+176	+282
	+125	+365	+95	+ 17	− 96	−74	+432	+535	+967
1966/67									
June ...	+ 43	+ 45	+23	+ 13	+ 2	−12	+114	+ 93	+207

Quarterly movements

The increase in borrowing from the P.W.L.B., the effects of the impending restriction on temporary borrowing, and the withdrawal of foreign funds in the autumn of 1964 can be seen from Table IV, which gives a quarterly analysis of local authorities' borrowing from the beginning of the financial year 1964/65 up to the June quarter of this year.

Perhaps the most interesting of the quarters under review is the December quarter of 1964. The local authorities then suffered from a severe withdrawal of overseas funds, which shows up as a net repayment of £124 million of temporary loans to accepting houses and overseas banks. This withdrawal occurred primarily because, during the sterling crisis, these banks suffered a substantial drain on their sterling deposits; those of overseas residents fell by about £140 million during this quarter. The high rates offered by local authorities, however, attracted money from domestic sources, notably the personal sector, and there was a net increase of £10 million in temporary loans from all sources. Moreover, bank overdrafts rose by £48 million, and many authorities borrowed heavily from the P.W.L.B., largely to take advantage of the favourable rates offered. Outstanding mortgages and 'over the counter' bonds fell by £6 million.

In the next quarter, ended March 1965, total borrowing requirements were much higher because of a drop of £200 million in rate income, as usual at its lowest in this quarter. Local authorities again borrowed heavily from the P.W.L.B.; and market conditions made it possible to raise a relatively large amount from stock issues, and to resume the issue of marketable bonds after an interval of five months. Furthermore, over £90 million was raised on mortgages and 'over the counter' bonds, largely from persons. Local authorities also raised about £100 million in temporary debt. Despite withdrawals by companies to meet tax payments and by building societies—which were themselves having to meet heavy withdrawals—temporary loans rose by £64 million. Some two thirds of the funds withdrawn by the accepting houses and overseas banks in the previous quarter were returned; the banks' sterling deposits continued to fall but the covered interest differential made it profitable for the banks to switch currency deposits into sterling for on-lending to local authorities. Many authorities also made exceptionally heavy use of bank overdrafts at the end of the quarter, and these rose by £33 million.

During the financial year 1965/66 the predominant factor was the availability of funds from the P.W.L.B. In the earlier part of the financial year access to the Board was limited only by the size of an authority's quota for the whole year. By the end of June £174 million—nearly half the amount expected for the whole financial year—had been taken. Borrowing from the market in the June quarter (when the total borrowing requirement is, in any case, seasonally low) was consequently very small, amounting to only £32 million. £49 million was raised on stock issues and a moderate amount on mortgages and 'over the counter' bonds; there was a net repayment of the large market loans but considerable borrowing of smaller amounts from persons. Consequently the local authorities had no need to bid up rates for temporary money in order to keep pace with euro-dollar rates (which were rising for external reasons) and the differential, after allowing for the cost of forward cover, became markedly unfavourable.[1] The accepting houses and overseas banks suffered a withdrawal of foreign currency deposits and switched back into currency most of the funds which, in the previous quarter, they had switched into sterling; their temporary loans to local authorities fell by £57 million. Local authorities attracted some £75 million of temporary loans from other (domestic) sources, however, and they were able to repay £77 million of bank overdrafts.

In July 1965, as mentioned earlier, it was announced that drawings of the remaining parts of P.W.L.B. quotas would be phased more evenly over the rest of the financial year; and in the six months July to December no more than £185 million was drawn, a halving of the monthly rate compared with earlier in the year. Market borrowing later in the year was consequently much higher than it had been in the June quarter, although by December drawings from the P.W.L.B. were beginning to pick up again. Issues of marketable bonds

(1) A chart showing the differential from 1964 to 1966 was given in the September *Bulletin*, page 210.

were large, particularly in the December quarter. Mortgages and 'over the counter' bonds produced as much as £225 million between July and December; persons continued to invest and an appreciable amount was also taken from the financial institutions. Temporary borrowing began to fall sharply in the December quarter—the first real sign that the impending restrictions were taking effect.

During the March 1966 quarter, borrowing from the P.W.L.B. was on the same massive scale as at the beginning of the financial year: many authorities' quotas had been underestimated because of the extent to which temporary borrowing was being replaced by longer-term debt. And just as much was taken from the market as in the previous quarter because borrowing requirements were seasonally high. The repayment of temporary debt continued. Substantial amounts were raised on stocks and marketable bonds, while borrowing on mortgages and 'over the counter' bonds (three quarters of it from institutions) continued at a heavy rate.

Drawings from the P.W.L.B. in 1966/67 were required to be phased over the whole year; and the amount drawn in the June quarter of 1966 was only half as great as a year earlier. Borrowing from the market (£114 million) was very much higher than a year earlier—and about as high as during both preceding quarters. Substantial amounts were again raised on stocks and marketable bonds, but there was very little change in the level of temporary debt, and the amount raised on mortgages and 'over the counter' bonds, much of it from persons, was the lowest for a year.

General assessment

Over the last decade a number of efficient and flexible markets, drawing on a wide variety of sources, have grown up to meet the needs of local authorities for funds. The recent introduction of marketable bonds suggests that these markets are still developing and would change readily in response to any relaxation of restrictions on the form in which local authorities can borrow. To attract funds through these markets, local authorities have at times had to pay high rates. In doing so they have, however, drawn considerable funds from the general public which in all probability would not have otherwise come to the public sector. At the same time the dangers which might arise from the continued unrestricted growth of local authorities' short-term borrowing from the public have been reduced by the restrictions imposed on temporary borrowing.

It can be argued that as a large part of local authorities' expenditure is effectively made on behalf of the central government, or in pursuance of central government policies, their finance should be provided entirely by the Exchequer at rates at which the central government themselves can borrow. Such co-ordination of public sector borrowing might not only reduce the cost of local authorities' money but might also give the central authorities more control over the financial markets. On the other hand, an increase in the amount of finance needed by the Exchequer would raise its own problems. If the Exchequer attracted all the funds from the general public which would otherwise have been lent to local authorities, the result would be merely a switch from one sort of public debt to another and there would be little or no monetary effect; but to the extent that the general public were unwilling to take up all the extra government debt, at rates of interest the Exchequer was prepared to pay and in the forms in which it was offered, the Exchequer would be forced to borrow the balance from the banking system. Bank deposits and bank liquidity would rise and this would affect the monetary authorities' control over the banking system.

The present arrangements aim at striking a balance that will allow the local authorities to obtain some of their finance through the Exchequer while not depriving the public sector of funds which the Exchequer could not itself readily secure but which the local authorities are able to attract by borrowing in the new forms which they have devised. There is value in allowing the local authorities to develop these new forms because, generally speaking, the wider the choice of assets available the more easily people will be induced to save. The present arrangements for dividing local authority borrowing between the Exchequer and the capital and money markets have suited conditions in the recent past, but as conditions change so it may be preferable to alter the balance.

Notes on sources and definitions

Local authorities include not only local government authorities—counties, boroughs, urban and rural districts, and parish councils in England and Wales, and their equivalents in Scotland and Northern Ireland—but also a number of other bodies, such as water boards and harbour boards, which are classed as local authorities in the national income accounts.

Local authority borrowing The totals of loan debt outstanding (Table I) are mostly based on the survey of local authority loan debt as at 31st March 1965 published in *Financial Statistics* for December 1965. This survey is not being repeated for March 1966, and the estimates of amounts outstanding in this article have been obtained by adjusting the survey figures by the quarterly changes published regularly in *Financial Statistics*. The figures for the P.W.L.B. include debt to the Northern Ireland Government Loans Fund. Mortgages, 'over the counter' bonds, etc. comprise a variety of forms of long-term non-marketable debt—including borrowing from an authority's own pension fund, a small amount of borrowing from government departments out of supply votes, and borrowing from other local authorities.

A total of temporary debt outstanding is produced quarterly by the Central Statistical Office and is published regularly. This figure has been used in this table. It excludes inter-authority debt—£54 million at end-March 1966—in order to show borrowing by local authorities as a whole. It includes, however, a few mortgages or 'over the counter' bonds which are repayable, by invoking a 'break' clause, before they have run for a year: these have been treated by the C.S.O. as temporary borrowing since the third quarter of 1965.

Internal advances and revenue balances used for capital purposes, which featured in the March 1965 loan debt survey, have been omitted from Table I, because they are purely internal book transactions and of no significance in a study of local authority borrowing.

Sources of borrowing Figures for the sources of borrowing given in Tables II and III for mortgages and 'over the counter' bonds and temporary loans, and on pages 340 and 341 for stocks and marketable bonds, are drawn from a variety of sources, as follows:

Banking sector figures are derived from returns to the Bank summarised in Tables 8 to 12 of the annex. Temporary loans by accepting houses and overseas banks, and by the discount market, appear in Table 8 as advances to local authorities: it is known that these institutions provide overdraft facilities on only a small scale. On the other hand, it has been assumed that the domestic banks' lending is entirely by way of overdrafts rather than temporary loans. The figures for bonds quoted in this article are not published separately.

Holdings of local authority debt by *other financial institutions* are taken from *Financial Statistics*. The division between insurance companies' holdings of mortgages and stocks has been estimated.

Overseas holdings of temporary debt are published in Table 20 of the annex. Figures for mortgages and 'over the counter' bonds are derived from the same sources as those for temporary loans. Estimates of overseas holdings of stocks include only holdings by U.K. agents for account of overseas residents—figures for stocks held in the name of overseas residents are not available but are almost certainly small. The figures generally are consistent with estimates used in the calculation of the balance of payments.

The holdings of *industrial and commercial companies* and of *persons* are based on the C.S.O.'s quarterly statistics (published in *Financial Statistics*). Absolute totals of temporary loans are reported each quarter, but only changes in holdings of mortgages and 'over the counter' bonds; the figures of mortgages and 'over the counter' bonds given in this article are therefore the aggregate of such changes added to a base figure for March 1962—see the March 1963 *Financial Statistics*.

The total of *temporary loans* in Table III differs from the total of temporary debt in Table I by the amount of bank overdrafts (£56 million in March 1966) and of bills (£8 million in March 1966). The treatment of bank overdrafts in these tables has presented some difficulty. The banking sector figures (Table 8 of the annex) show gross lending outstanding by domestic banks to local authorities (which is assumed to be all on overdraft) at £123 million in March 1966, to which must be added some allowance for overdrafts from overseas banks; Table 8 also shows gross deposits by local authorities with banks at £159 million at the same date, so suggesting that deposits by local authorities with banks and overdrafts of local authorities with banks were nearly equal. However, the returns made by the local authorities, which relate specifically to bank overdrafts and are published in the local authority section of *Financial Statistics*, show a figure of £56 million overdrawn at March 1966. This figure is the sum of overdrafts, if any, on all accounts of each reporting authority (many authorities have more than one bank account) but it takes no account of any authority with a net position in credit. The two series are therefore irreconcilable. The treatment of overdrafts in this article is a compromise. The discussion in the paragraphs on temporary debt draws on the banking sector's figures in the annex; but the calculations of total debt (Table I) and of quarterly movements (Table IV) use the series in *Financial Statistics* in order to maintain consistency with the regular series of published statistics of local authority borrowing.

The *quarterly analysis of local authority borrowing* (Table IV) is based on figures published in the local authority section of *Financial Statistics*; however, it separates loans from accepting houses and overseas banks (Table 8 of the annex) from other temporary borrowing.