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The Rt Hon The Viscount Whitelaw CH MC
Lord President of the Council
Privy Council Office
Whitehall
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My ref:

Your ref:

5 November 1986

Dean Liskie

Any PV comments?

JLS
7/14

A key proposal in the Green Paper package is that power to set non-domestic rates should be taken out of the hands of local authorities, and that the proceeds should be pooled and redistributed as an equal amount per adult. This is designed both to protect businesses from excessive rate bills over which they have no say, and to ensure that local voters bear the full effect of variations in local spending.

The Green Paper leaves one major issue and a number of subsidiary issues to be resolved. The major issue is the basis on which non-domestic poundages should be set at the outset of the new system, ie a uniform poundage or frozen current poundages. The other issues are:

- i. once set, the basis on which rate poundages should be indexed:
- ii. what account to take of annual increases in total rateable value:
- iii. the future of the existing arrangements for discretionary reliefs from rates:
- iv. where the burden of losses in collection should fall:
- v. the form of transitional protection to be offered to those who will lose from these proposals:
- vi. whether to pursue the proposal that authorities should retain the power to raise a small discretionary non-domestic rate.

This letter sets out my proposals on the main issue of uniform or frozen poundages, and on items i - iii above. I will put proposals on items iv - vi later.

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Coverage

My proposals do not apply directly to Scotland. There, as foreshadowed in the Green Paper, I know Malcom Rifkind intends that poundages will as an interim measure be frozen, not equalised: this is much more readily justified there as the range of poundages is far narrower. On the choice of index and the treatment of buoyancy, however, it is important that Scottish and English practice do not diverge.

The Green Paper envisages that the structure of non-domestic rating in Wales would be the same as in England, though - if the uniform poundage is adopted - the poundage in Wales would differ from that in England, in order to retain the present average burden on Welsh business ratepayers.

Uniform or frozen poundages

The Green Paper makes clear that the government's preferred option is a uniform poundage set at the average poundage for the preceding year. It notes as an alternative, however, the possibility of freezing the present pattern of rate poundages.

The Green Paper sets out clearly the case against freezing the present pattern of rate poundages. These now vary very widely, with a ratio of 3:1 between the highest (Newcastle) and the lowest (Kensington), although there is little evidence of variation in the services authorities provide to businesses. Freezing them would do nothing to remove the distortion of competition that they produce, nothing to redress the disincentive to economic development in high-rated areas, mostly in the North and inner London and nothing to reduce the pressure for excessive development in parts of the South East. It would be impossible to defend charging a business in Hackney twice the rates of an equivalent business in Wandsworth, once the poundage was set by central government and was explicitly detached from any variation in service levels.

The case for freezing lies in the increases that a uniform poundage would require in low-rated areas. On 1986/7 figures, these could be up to 82% in Kensington, 57% in Wandsworth, 40% in Bromley and Croydon, and 32% in the City. However, the very low rate poundages which low-spending London boroughs were able to charge in 1986/7 in the aftermath of the abolition of the GLC may well rise, so the size of increases in these areas resulting from introduction of the NNDR by less 1990. There would also be increases of typically 5-20% in many Conservative shire areas: in some of these areas businesses, especially retailers, will also face losses from revaluation. Overall, gainers and losers will be roughly in balance, with only one ratepayer in seven facing an increase over 15%.

Response from business to our proposals has been mixed: but there has been relatively little protest against the uniform rate proposal. Westminster City Council's attempt to stir up a campaign among low-rated authorities attracted little support. The CBI are clearly ambivalent, having a regard to the gains to their members in the North and wider benefits of indexation. They have expressed support for the principle of a uniform poundage, subject to its being set 25% below the present average, which would reduce the proportion of losers to about 5%, at a cost of £2bn. Clearly, given the difficulties we face in securing acceptance for the community charge,

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we cannot risk putting this extra burden (£50 per adult) onto domestic taxpayers. We can however look again nearer the time at whether some small reduction in the overall burden on industry might be justified. In considering the position of business losers, we also have to bear in mind our community charge proposals offer major gains to residents in low-spending shire areas, and represent a significant transfer of resources into those areas. The uniform business rate is a quid pro quo for the cities, without which our proposals would be much more vulnerable to attack as socially and politically divisive. I therefore propose that we should confirm that the non-domestic rate poundage will be uniform throughout England.

The difference in approach from that proposed in Scotland will need careful presentation. The key points are that freezing poundages in Scotland is an interim measure until Scottish and English valuation practices can be harmonised, and that progress is being made on that front; and that the range of rate poundages in Scotland is much narrower, so the need to reduce it is correspondingly less.

A crucial element in reconciling potential losers to the proposal will be carefully-designed transitional measures to protect the bigger losers from both the NNDR and the 1990 revaluation. If these are to be out of the system before the next revaluation, assumed to be in 1995, we cannot limit the maximum annual increase to less than 20% compound. The numbers facing such increases will however be fairly small: outside Kensington and Wandsworth, only high street shops - which have profited greatly from the delay in revaluation - would face increases on that scale for more than two consecutive years. There are several ways of handling transition: I shall put more detailed proposals to the sub-committee once the pattern of likely gains and losses is clearer.

Other issues

Indexation I propose that the index to be used should be the RPI, which is by far the most widely understood measure of inflation. Despite its possibly greater volatility because of the inclusion of housing costs, it seems preferable to the GDP deflator, which is subject to frequent retrospective adjustment, or a local authority cost index, which is preferred by local authorities but which would underwrite excessive wage settlements. I also propose that indexation should relate to the past year's inflation: no use should be made of inflation forecasts, which could give rise to a need for retrospective adjustment.

Treatment of buoyancy The non-domestic rate base typically grows by 1-2% a year. If we were to index the NNDR poundage, local authorities would receive the benefit of this growth, amounting to $\frac{1}{2}$ - $\frac{2}{3}$ of their total income. I have considered carefully whether we should deprive them of this source of finance for growth - as the Green Paper suggests we might - by instead indexing the yield. There must be a danger - indeed a probability - that however hard we try to restrict it, local government spending will in practice continue to grow in real terms, as it has in recent years, because of demographic pressures and the high proportion that labour costs form of the total. If we were to reduce the share NNDR provided of authorities' total expenditure, as would be likely if we indexed the yield rather than the poundage, this would increase the pressures on

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the community charge. In itself that might not be unwelcome, but in practice it is bound to generate pressure for an increase in the amount of central grant. I therefore propose that we should index the poundage, which is in any case much simpler to explain and present.

Discretionary reliefs Local authorities have discretion to top up to 100% the 50% mandatory relief for charities, and to give up to 50% relief to other non-profit-making bodies. I have no wish to disturb the arrangements. If, under the pooling system, authorities were assumed to be levying the full rate, the cost of giving relief would fall wholly on local domestic taxpayers, and authorities' readiness to give relief would be much reduced. Moreover, the cost will no longer be spread across a wider area through precepts. I therefore propose that discretionary relief for charities etc should be retained and that half the cost - roughly equal to the share now borne by local non-domestic ratepayers - should be borne by the pool.

Authorities also have discretion whether to levy rates (at up to 50% of the full rate) on empty shops and offices, though not factories or warehouses. Arguably, with a uniform rate, the treatment of empty property ought to be uniform. On the other hand standardising on 50% everywhere would provoke protests from those who benefit now, no doubt including some hard cases. I propose to consider this issue further, with a view to possible separate consultation with business organisations, and put proposals to colleagues later.

Conclusion

I should be pleased to know if you and colleagues agree:

- i. that at the appropriate time we should reaffirm that there will be a uniform non-domestic rate in England (paragraph 9), probably set at a national average poundage, though we can consider later whether there is a case for setting it at a lower level;
- ii. that the poundage should be uprated in line with the past year's RPI (paragraph 12);
- iii. that there should be no offset for buoyancy in the rate base (paragraph 13);
- iv. that half of the cost of discretionary reliefs should be borne by the pool (paragraph 14);

I also ask you to note that I shall put proposals at a later stage on the suggested local discretionary rate, the form of transitional protection for ratepayers facing losses, and the method of financing any shortfall in payments into the pool.

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I am copying to members of E(LF) and to Sir Robert Armstrong. In view of Malcolm Rifkind's need to announce decisions on those issues dealt with here that concern him when he introduces his Bill, I should be grateful for replies no later than 12 November.

*James
Amis*

NICHOLAS RIDLEY

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Local Gov't : Rating Reval. PTS.

