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NOTE OF A MEETING HELD AT 10 DOWNING STREET AT 1545 HOURS ON 2 OCTOBER
TO CONSIDER THE FUTURE OF THE RATING SYSTEM

Present: Prime Minister

Secretary of State for the Environment

Minister for Local Government and Environmental Services
(Mr. Tom King)

Mr. M.A. Pattison

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The Prime Minister said that she was now concerned as much about industrial rates as about domestic. Mr. Heseltine agreed that industrial rates were now a major problem, covering £6.7 billion in annual revenue. He had been studying alternatives to the rating system in some detail. He was now concerned that any alternative would prove no more satisfactory than the present system. Unfortunately many people believed that the abolition of rates would mean the abolition of the expenditure financed from rates. There was a risk that any alternative system would therefore produce a worse reaction.

Mr. Heseltine saw particular problems in making changes in the present climate. The Government was committed to squeezing public expenditure. The best alternative system -- an income or sales tax -- would produce both lumpy and buoyant revenue. There was also a belief in the country that the rating system did apply some discipline to local authority expenditure. Any new system might appear to lose this advantage. He was optimistic that the new block grant system would have a salutary effect on local authorities. He was already having to seek ways of lessening its effect in London. He acknowledged that the Party had a commitment to tackling the problem of rates. He now felt that his paper to colleagues should focus on ways to eliminate the anomalies within the system, and not on its replacement by a new tax. The worse excesses of the present system were confined to a few places, and block grant would change much of this.

/ The Prime

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The Prime Minister responded that this was not good enough. Rates in their present form were a most undemocratic tax. She would much prefer to see rate support grant meet 90% of local expenditure than the continuation of the present system. Rates involved two expensive and unnecessary blocks of administration - the assessment and rebate systems. A link to the tax system would also save on collection costs. Industrial rates might have to accrue to central government, to prevent Labour authorities levying even greater charges on private industry.

Mr. King saw difficulties in greater funding through the centre, although there was now a high proportion of central funding in Scotland and Wales. There were already signs that Labour authorities like Lambeth and Manchester felt unable to propose further major rates increase next year. Experience showed that local authorities always responded to central government pressure for cut backs, even if it took time.

The Prime Minister said that the rating system was tied to a notion of a private rented sector, but this not longer existed. If there had to be a property tax, it would be fairer to base it on square footage. Mr. Heseltine pointed out that this would need massive equalisation arrangements, and the net result would be expensive change with little real differences in what individuals paid. Rates were always controversial when they rose fast in periods of high inflation. If the Government won its economic battle, rates would cease to be a major issue within 18 months. Over time, local government had an excellent record of meeting expenditure targets. Central government set volume figures, and was therefore responsible if the targets were too high. Manpower remained the key. Results were just beginning to come in. He and Mr. King had been unwise to accept in the previous year that local authorities would tackle this problem, but now the September quarter was likely to show the biggest fall ever. The Prime Minister suggested that, with spending volume set for three years ahead, the Government would need a further volume squeeze through cash limits. Mr. Heseltine said that this must not be done in a way which distinguished local from central government. The local record was better on wages in the last year if Clegg awards were excluded.

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/ Mr. Heseltine

Mr. Heseltine said that the Party Conference motion called for the abolition of domestic rating. If he could get the Chancellor's agreement, he would like to say that he wanted to deal especially with the problem of the widow/widower in the large family house. In effect, he wanted a reverse poll tax arrangement. He would avoid the problem of concealment of who was living in a house and the need to check this by putting the onus on the ratepayer to apply for this treatment. The Prime Minister felt that this would simply add one more anomaly to the system. The issue needed to be examined much further.

In further discussion, the Prime Minister touched on the possibility of individual cash limits for each local authority. Mr. King expressed some surprise. The Prime Minister said that she was being told that the Government could do nothing. She could not stand this approach and did not believe it. To her surprise, Mr. Heseltine was becoming a prisoner of his officials. Mr. Heseltine stressed that he had examined the issue personally in great detail, and that the recommendations were his own. In practice, other systems were only working in countries with a geographical land mass suited to local revenue. Given the public expenditure constraints, he saw no real scope for change. The Prime Minister suggested that he should consider industrial derating in England and Wales like that in Scotland. She accepted that rates could not be abolished in this Parliament. But she still wished Mr. Heseltine to develop a scheme for their gradual removal. Mr. King asked whether this should be a greater priority than reduction in personal tax. The Prime Minister said not. She still saw a sales tax, part of which could be tied to local needs, as the best option. But she would go for a much higher RSG with a correspondingly limited role for the tax. Mr. King stressed that any change in the rates system would be wildly unpopular with the local government community. The present level of domestic rates was the equivalent to 4% on VAT. The Prime Minister said that any additional sales tax or alternative scheme would have to have a neutral effect on the retail price index. On industrial rates, a different collection system was required. We should study the operation in other countries. Small businesses faced horrendous problems from rates. Mr. Heseltine pointed out that any possible system would leave businesses to provide the same revenue somehow.

The Prime Minister suggested that there might be a pilot study to assess reactions if council tenants were offered a reduction in charges, equal to the rate element in their rent, at the price of a local increase in VAT or a sales tax.

In further discussion, Mr. Heseltine stressed his concern about any move in a direction which conflicted with basic Government strategy. He and Mr. King had come simply to expose to the Prime Minister the difficulty they had encountered. The Prime Minister conceded that many 1980 rate increases might have been set as a basis for avoiding further increases in 1981. She also accepted that if a new easily raised, tax was introduced, public expenditure would go up.

Mr. Heseltine suggested that, in reply to the Party Conference motion, he should look at possible palliatives, refer to the prospects for the block grant system, the effects of which had yet to be evaluated, and stress the public expenditure dimension. This would serve to keep the ball in the air, which he had achieved for several years up to now. The Prime Minister agreed that public expenditure problems should be stressed. She wished Mr. Heseltine to agree publicly that the rating system was unfair. He could then point to the risk of change for its own sake which could produce an even more unfair system. It was therefore necessary to think through the consequences most thoroughly. He should rule out any change to a capital base.

In conclusion, the Prime Minister asked Mr. Heseltine to keep working at the problem. £3 billion was not so enormous a sum that there was no alternative means of raising it. But she accepted that industrial rates would need to be tackled on a similar timescale.



3 October 1980

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PRIME MINISTER

no papers required.

Michael Heseltine would like to have another word with you about the future of domestic rates. You will know that he has to reply to a difficult motion at the Party Conference. I have put him in for 15 minutes at 0915 on Thursday 2 October, immediately before E.

MA

Agreed

19 September 1980

15.30

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VLS



FILE

Local Grant

10 DOWNING STREET

From the Private Secretary

2 October 1980

Future of the Rating System

Your Secretary of State, accompanied by Mr. King, spoke to the Prime Minister this afternoon about their work on the future of the rating system.

Your Secretary of State explained that, after examining the available options, he had reached the preliminary conclusion that any alternative was likely to be at least as unpopular as the present system. In addition, the most likely alternatives, such as local income tax or sales tax, would produce a local revenue system which was both lumpy and buoyant. This would be counter productive at a time when Ministers were trying to squeeze expenditure at all levels. He was due to produce a paper for colleagues shortly. He now felt that that paper should be focussed on seeking means of eliminating anomalies within the rating system instead of ways to replace rates with a new tax.

In the course of a lengthy discussion, the Prime Minister made it clear that she was not prepared to abandon the objective of replacing the rating system. She acknowledged the formidable difficulties. She would be happy to explore arrangements which substantially increased the proportion of local expenditure funded through the Rate Support Grant. She felt that there should be ways of applying a sales tax system, but if your Secretary of State really found no alternative to a property tax, she would prefer to see one based on space in preference to the present system linked to the concept of a rental market in private housing which was now defunct.

At the end of the discussion, your Secretary of State suggested that, for immediate purposes, he should look at palliatives to deal with the worst anomalies, and he should at the same time make it clear that Ministers were waiting to assess the way in which block grant worked, at a time when public expenditure considerations were paramount. The overall issue of rating reform would thus be left open.

/ The Prime Minister

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The Prime Minister did not dissent from this approach. She agreed that the public expenditure constraints must be stressed. She felt that your Secretary of State should endorse the view that the rating system was unfair, whilst emphasising the need to avoid change for its own sake which might result in an even more inequitable system. The consequences of any change would need to be thoroughly thought through, and the idea of any change to a capital base clearly discarded. The Prime Minister also stressed that she was not ready to accept failure in the search for an alternative to domestic rates as a means of raising local revenue. She accepted that it was not now possible to tackle the issue in isolation from the growing problem of industrial rates.

M. A. PATTISON

David Edmonds, Esq.,
Department of the Environment.

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