CC E/UP CC BG

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Please pull the pps together for the meeting.
DRN 18/11

PRIME MINISTER

NATIONAL NON-DOMESTIC RATE: TREATMENT OF BUOYANCY

E(LF) is to meet on Thursday to discuss, inter alia, the way we treat growth in the non-domestic rate base. Relevant papers are:

i. my letter of 5 November to Willie Whitelaw; at flap

ii. letters of 17 November from John MacGregor, Malcolm Rifkind and Nicholas Edwards broadly supporting my proposal;

iii. letters of 9 November from Norman Tebbit, 11 November from Paul Channon, and 13 November from Kenneth Clarke, proposing an alternative approach.

I summarise the issues below.

As you know, a key feature of the new local government finance system is the setting of a uniform national non-domestic rate, set at the national average and thereafter linked to a measure of inflation (which I have proposed should be the RPI), and redistributed to local authorities as an equal amount per adult.

What is at issue here is how we treat growth in the total of non-domestic rateable values. This will take place, regardless of inflation, because of continued building and improvement of factories, offices and shops. In recent years this has amounted to 1-2% pa.

There are two alternative courses:

i. We could index the non-domestic rate poundage. If so, the yield would grow in real terms by the amount of the growth in the rate base, and this would be distributed to local authorities.

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ii. Alternatively, we could remove some or all of this benefit by uprating the poundage by less than the full RPI increase. Norman Tebbit, Paul Channon and Kenneth Clarke have proposed a standard 15% offset, which would, on past form, remove most though not all of this buoyancy.

I had proposed leaving the benefit of buoyancy with local authorities partly on grounds of simplicity. It is far more straightforward and comprehensible to increase the poundage by the full amount of the RPI increase than to adjust it by what is inevitably an arbitrary deduction. But there is also a question of realism. The question is whether it is realistic in view of the demographic and wage pressures to expect to make real terms reductions in local government spending over a sustained period. The best we can expect is to cut it as a share of GDP. But if we were to hold income from the non-domestic sector constant in real terms, as Norman's proposal would involve, then any real growth would have to be financed from other sources: either the community charge, or Exchequer grant increasing the pressure on central taxation.

If we could be sure that the pressure would be taken on the community charge, that might be no bad thing. But our policy of introducing the community charge is going to face severe pressures, even at present likely levels of charge. If we were to put additional burdens on it, we would be bound to face continuing pressure for an increase in grant financed from national taxation.

It is also relevant that in giving local authorities the benefit of buoyancy in rateable values, we shall not be imposing any extra burden on individual businesses. Their rate bills will increase only in line with inflation, which is what we have promised.

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As John MacGregor says, in deciding whether to give up the benefit of buoyancy in a tax base, we should err on the side of caution. I therefore stand by my earlier proposal to index the poundage.

Paul Channon and Kenneth Clarke have also raised the issue of whether we should - as the CBI have proposed - limit or reduce the overall burden on business, either between now and 1990 or under the new system. As for the short term, I do not believe this would be practicable: it would require complicated main legislation, and would be very difficult to integrate with the present rate support grant system. For the longer term, I would be willing to consider Paul's proposals sympathetically, though I think it would be premature to reach a firm conclusion on the balance between business rates and other businesses and personal taxes and central grant in 1990 and beyond. Perhaps we can come back to this issue later.

Nicholas Edwards has proposed that instead of indexing to the RPI, we should use the GDP deflator. The main case for using the RPI is very simple: that people have heard of it and understand what it represents. Moreover the GDP deflator is subject to retrospective changes which would complicate the process of indexation and of much of its certainty. I note that John MacGregor, Malcolm Rifkind, Paul Channon and Norman Tebbit support me on this, and hope that Nicholas can agree to withdraw his proposal.

Kenneth Clarke draws attention quite rightly to the need for carefully constructed transitional arrangements. I agree. I think, though, that we would do better to leave the detailed design of those arrangements until we have a better picture of the changes in the non-domestic rateable values on revaluation.

Finally I can give Kenneth the assurance he seeks that present reliefs for Remploy and similar bodies will be unaffected.

I shall write separately to Malcolm Rifkind about the issues he raises on the timing of future revaluations.

I therefore seek agreement:

i. to index the national non-domestic rate poundage rather than the yield, thus leaving the benefit of buoyancy to lie with local authorities;

ii. not to pursue the idea of interim limitation of businesses rates, but to consider at a later stage whether to set the uniform poundage below the present average at the outset of the new system;

iii. to use the RPI in preference to the GDP deflator.

I am copying this minute to other members of E(LF) and to Sir Robert Armstrong.

N R

18 November 1986

LOCAL GOVT Rating PT5