



CCBG
BLUP

NON-DOMESTIC RATES

DECISIONS

1. The issues for decision are:
 - i. Should any allowance for buoyancy be built into the indexation formula for the National Non-Domestic Rate (NNDR);
 - ii. Should the NNDR be indexed to the RPI or to the GDP deflator;
 - iii. Should the rates burden on business be limited or reduced, either between now and 1990 or under the new system.

The key text is the Environment Secretary's minute to you of 18 November. That, together with this brief, covers the main points of which you will need to be aware.

BACKGROUND

2. The Green Paper 'Paying for Local Government' indicated that non-domestic rates would continue in the reformed local government finance system, since there were few other taxes that could sensibly be substituted. With the abolition of domestic rates, however, local authorities could not be left free to determine the non-domestic poundage unconstrained. The Government therefore suggested a nationally determined non-domestic poundage. In order to reassure business against the possibility of a future government raising the national poundage excessively, it was proposed to index it by statute in order to keep the burden roughly constant in real terms. An alternative possibility was to freeze the existing pattern of local poundages, allowing an annual increase to reflect inflation only.

3. The response from business has been mixed, but there has been relatively little opposition to the uniform rate proposal. Mr Ridley therefore proposes that this preferred option should be endorsed, and no Minister has dissented from this. There is, however, disagreement

about the precise formula for the indexation; and some Ministers have also suggested that steps should be taken to reduce the total burden on business, either in the run up to the new system, or in the longer term.

4. In Scotland, it has been agreed that as an interim measure the existing local poundages will be frozen in 1989 and increased thereafter in line with inflation. In due course it will have to be decided whether and how Scotland should be brought into line with England and Wales when uniform national poundages are introduced in those two counties. This does not have to be settled now, although it will raise difficult problems of revaluation and of transfers to Scotland if a uniform GB rate were applied.

THE ISSUES

Treatment of Buoyancy

5. The aggregate total of non-domestic ratable values increases by about 1-2 per cent per year as a result of new building and improvements to existing buildings. If, therefore, the rate poundage is increased annually in line with inflation, the actual yield would increase by 1-2 per cent in real terms. Some Ministers - Chancellor of the Duchy, Paymaster, and Trade and Industry Secretary - have suggested the Government should adopt a policy of maintaining the yield constant in real terms. This would entail increasing the poundage by, say, 1 per cent less than the rate of inflation each year, giving individual businesses a progressive real reduction in their rates.

6. Other Ministers, however, question whether this is realistic - the Environment, Scottish, and Welsh Secretaries, and Chief Secretary. They believe that in a growing economy it is unlikely that local authority spending will stand still in real terms over a period of years. Well over half their spending is on wages, and earnings in the economy generally will grow. So while there is scope for economies, and the Government must aim to reduce local authority expenditure as a percentage of GDP, some real growth is inevitable. If this is so, and the contribution from non-domestic ratepayers is frozen in real terms,

the burden of financing real growth would fall either on the Exchequer or on the Community Charge. In principle the latter is, of course, desirable and consistent with the Government's central aim of restraining local government expenditure by promoting increased local accountability. But, as Mr Ridley points out, the introduction of the Community Charge is likely to meet teething troubles enough, and the chances are that - at least in the early days - any further pressure (eg from restraining the yield from the NNDR) would simply be translated into extra pressure for more central government grant.

7. The arrangements for controlling British Telecom prices may be prayed in aid of an indexation - X formula. But BT's sales revenue can be expected to be at least as buoyant as growth in GDP if not more so, whereas the increase in ratable values will be 1-2 per cent less than GDP. A closer analogy is the TV licence, where MISC 128 has agreed that the BBC may have the benefit of buoyancy in the number of licence payers. (The Government also, of course, benefits from the buoyancy in customs duties and some other taxes.)

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reply.
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Which Measure of Inflation?

8. The Welsh Secretary has proposed the GDP deflator. This is the most general measure of inflation across the whole economy, and is theoretically a fairer measure of the increase in the capacity of industry and commerce to pay and in local authorities' increases in cost than the RPI, which is based on a basket of consumer goods. But few people will have heard of the GDP deflator, which is largely a construct by Government statisticians, and has the technical defect of requiring retrospective adjustment. The RPI is much better known and understood, and is already used for many other purposes (the index-linked saving certificates, for example, are linked to the RPI) and you should be able to secure agreement on that.

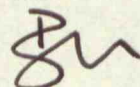
Reducing the Burden on Industry

9. The Trade and Industry Secretary, supported by the Paymaster General, has raised the general question of whether the overall burden on business can be reduced under the new system. This is, of course, related to the issue on the formula and in relation to Scotland

discussed in paragraph 6 above. It does not, however need to be resolved now, and Mr Ridley has already agreed to consider Mr Channon's proposals sympathetically over the next few months. It is also common ground between them that first it may be appropriate when establishing the initial NNDR to disregard any excessive increases made by local authorities between now and 1990; and second that a transitional period will be needed to phase in the new arrangements to protect those who will face increases. But beyond that, any relief for business can only be provided by shifting the burden either to the Exchequer or to the domestic sector. The proposals in the Green Paper, and in particular the exemplifications, were explicitly on the basis that the balance between the Exchequer and the domestic and non-domestic sectors should continue broadly unaltered, although with the safeguard that local authorities should not have recourse to business to finance excessive increases. These issues can be considered further as the proposals for England and Wales are drawn up over the next few months.

HANDLING

8. You will wish to invite the Environment Secretary to introduce the discussion, and the Scottish Secretary to contribute. The Trade and Industry Secretary will wish to argue for the protection of business interests. The Chief Secretary, Treasury and other Ministers will wish to contribute to the discussion.



J B UNWIN

Cabinet office
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