

PRIME MINISTER

19 November 1986

E(LF): THURSDAY 20 NOVEMBER

You are taking a meeting of E(LF) to discuss national non-domestic rates and exemptions from the Community charge.

National Non-Domestic Rate

There are three unresolved issues. First, whether the uniform rate poundage should be increased in line with inflation or by somewhat less to take account of the natural increase in total rateable values arising from new developments. Nicholas Ridley, John MacGregor and the territorial Secretaries of State all argue that local authority expenditure is bound to increase in real terms and that if the yield from the uniform business is not allowed to grow, this increase will have to be funded either from central Government grant or from the Community charge. They fear that practical politics will mean that grant rather than the Community charge will bear most of the strain.

We do not accept this line of reasoning; it conflicts with the fundamental approach of the new system which is that marginal pressures for increased expenditure by local authorities should be met through the community charge. We also see no reason why the full benefit of increasing total rateable values should accrue to the local authorities; this conflicts with the Government's public expenditure objectives generally that the public sector should take a decreasing share of national resources in real terms.

Not
necessarily.

The choice is therefore between indexing the yield which would give the local authorities none of the benefit in real terms from increasing rateable values and allowing local authorities part but not all of the increase. Indexing the

yield has the merit of simplicity but you know how difficult the Government has found it keep public expenditure generally constant in real terms. We therefore favour as the most realistic allowing the local authorities part if not all of the increase. This can most easily be done by increasing poundage in line with inflation minus X where X is in the range $\frac{1}{2}\%$ -1%. This approach is well established for the privatised public utilities.

The second issue is whether the index of inflation used should be the RPI or GDP deflator. The GDP deflator is the better measure of price increases in the economy as a whole But the RPI is much better understood by the public and used for uprating Social Security benefit and regulating the prices of privatised public utilities. We therefore favour using the RPI.

The third issue is the level of non-domestic rates. We do not favour Paul Channon's proposal to cap business rates in the period up to 1990 because this will be a major change to the existing rating system requiring legislation. Nevertheless we share the worry that local authorities will try to maximise rate income in order to maximise the take from the uniform business rate. The initial rate poundage for the UBR should therefore be based on the yield from business rates in 1986/87, indexed by the RPI - X formula. Kenneth Clarke proposes a long term target uniform business rate poundage in real terms. But the RPI - X proposal is better than this because it ensures a continuing decline in the poundage.

Possible exemption for the mentally handicapped

Nicholas Ridley has accepted that 18 year olds still at school, prisoners and resident hospital patients should be exempt from the Community charge on the grounds that they are either without income and have no access to Social Security benefits or that they make no or very little use of local authority services. Malcolm Rifkind proposes that the mentally handicapped should also be exempt from the Community charge on the grounds that accountability means very little in their case.

We think that exemptions from the Community charge should be kept to the very minimum because otherwise it will be very difficult to defend special pleading. For example, if an exemption is granted for the mentally handicapped why not the senile elderly? And if them, why not other very frail elderly people? Provided the Social Security system can ensure that such people are able to meet their Community charge liability we prefer this option to exemption. We therefore do not favour exempting the mentally handicapped from the Community charge.

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