

CONFIDENTIAL



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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Nicholas Ridley AMICE MP  
 Secretary of State for the Environment  
 2 Marsham Street  
 LONDON SW1P 3EB

*21<sup>st</sup>* November 1988

*For Nick,*

HARMONISATION OF RATING: THE CONTRACTOR'S BASIS *hap*

Thank you for my copy of your minute of *5* October to the Prime Minister. I am sorry that seasonal pressures have delayed preparation of this reply.

I agree with you that we should plan to prescribe on a national basis the decapitalisation rate to be used in the contractor's basis revaluation. My main concerns are as follows.

First, I am concerned to maintain the total yield of rates paid by private businesses rather than allow this significant element in the tax base to be eroded.

If we raise the public sector decapitalisation rate (as I think we are bound to do), a side-effect of this, within any given total of NNDR payments by the public and private sectors taken together, will be to reduce the yield of rates from private businesses (because most contractor's basis and formula rated businesses are in the public sector).

The solution, as I see it, is to separate out the decapitalisation rate decision from the decision on the total amount of rates to be raised from private businesses. This can, I believe, be quite simply achieved. The Government has stated its intention to maintain the 1989-90 yield of business rates in real terms in 1990-91, plus the normal annual buoyancy in the rates base. We need to interpret this commitment as applying to the total of private business rates rather than the total of public and private business rates. As I see it, this is consistent with the general undertakings we have given to business, with the legislation, and with my Written Answer in the House on 11 March. I suggest that we should proceed on this basis.

My second concern relates to your suggestion that we should set a special lower decapitalisation rate for all educational establishments. It would in my opinion be exceptionally difficult to justify differential treatment for educational buildings as against hospitals and other public sector buildings. We can provide a reasonably convincing justification for giving the public sector in general a somewhat lower decapitalisation rate than the private sector, given the lower risks in renting to the public sector, the finer debt servicing terms obtainable by the public sector and the existing precedent. There do not appear, however, to be any comparable reasons which would justify a special rate for educational buildings. I am aware that the existing legislation may preclude us from prescribing decapitalisation rates for particular categories of user as against particular categories of building, and this constraint has doubtless influenced your proposal. I believe, however, that the better way ahead will be to include the necessary small technical amendment in the forthcoming Housing and Local Government Bill so that we may prescribe a public sector rate.

My third important concern is to avoid any unnecessary increase in the public expenditure totals. Other things equal, a higher decapitalisation rate in the public sector will raise the public expenditure totals, both general government expenditure and the new planning total, since rates paid by local authorities and contributions in lieu of rates paid by the central government both count, directly or indirectly, towards both expenditure totals. It will also raise departmental running costs.

Against that background, I believe we should go for the lowest decapitalisation rate we reasonably can for the public sector in general, including public sector educational establishments. The existing public sector rates are mostly  $3\frac{1}{2}$  per cent in England and Wales, set in 1973, and 5 per cent in Scotland, set 10 years later. Given the increase in interest rates and rental/capital value ratios since 1973, I believe that the minimum defensible rate would now be 5 per cent. I calculate that this would raise general government expenditure, and the new planning total, by at least some £280 million a year (GB), comprising additional central government contributions in lieu of rates of some £100 million plus additional non-domestic rates payments by local authorities of some £180 million. These public expenditure effects are very similar to those which would result from your own proposals.

In practice, the public expenditure totals could all too easily rise by more than the £280 million. This would happen if the extra government contributions in lieu of rates were allowed to lead to an increase in total grants to local authorities and in their total expenditure. I am sure you will agree that we must do all we can to limit the increases to £280 million. To that end, it will be essential to ensure that RSG and the increased government contributions in lieu of rates, taken together, are no higher than they would otherwise have been, so that there is no increase in the total of government grants to local authorities as a result of higher contributions in lieu.

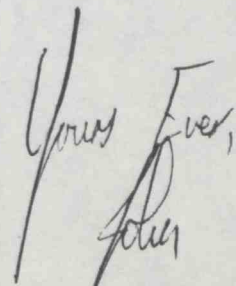
I do of course fully share your concern to avoid significant increases in the Community Charge, which you estimate to be about £3 on your proposals. My proposals in this letter, taken together, would avoid any increase in average Community Charges.

Whether we need to continue with a concessional rate for educational charities (largely confined in practice to private schools and the private university) seems to me a matter for collective Ministerial judgement. The present rate is 2½ per cent in England. I would see considerable merit in ending this concessional rate and treating these establishments in the same way as the rest of the private sector, especially at a time when the recent House of Lords vote has raised the rating relief on all charities from 50 per cent to 80 per cent. Removing the concessional rate would however largely remove from educational charities the benefits they obtained from the House of Lords decision. I suspect colleagues will feel that some concessional rate should be retained for education charities (whether 4 per cent, as you envisage, or the existing rate of 2½ per cent), and frankly I share this view.

The other main issue for consideration is the level at which the private sector decapitalisation rate should be set. Provided that we maintain the total yield of private business rates as suggested above, this will affect only the distribution of the rates burden within the private business sector, between conventionally-rated businesses and contractor's basis-rated businesses. The higher the decapitalisation rate, the larger the share of total business rates paid by the latter businesses will be.

In setting this rate there are, I believe, three considerations which we need to have in mind. First, the professional calculations, though necessarily somewhat tentative, point to 7 per cent as being the most appropriate rate. Second, while it is just about defensible to set the private sector rate above the public sector rate, it would be difficult to justify a large divergence. Third, we need to have in mind that the chemical industry, British Steel, and the privatised airports (among others) will lobby strongly for keeping the present rate of 5 per cent. The conclusion which I would draw, like Malcolm Rifkind, is that the best tactic will be to consult on a range of 6 per cent to 7 per cent for the private sector rate.

I am copying this letter to the Prime Minister, other members of E(LF) and to Sir Robin Butler.

*Yours Faithfully,*  


JOHN MAJOR

LOCAL GOVT: Rating P111

