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CONFIDENTIAL

The Rt Hon John Major MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1

NB: Mr. Chief
Secretary has commented.

PEC6

9 January 1989

Dear John,

THE BURDEN OF BUSINESS RATES IN SCOTLAND

In a minute of 28 June to the Prime Minister Nicholas Ridley drew attention to the fact that, even when rateable values north and south of the Border have been harmonised, businesses in Scotland would still be paying far more rates than in England because rate poundages would be far higher than the English UBR. I agreed with him that it would be impossible to defend these differences and that officials should pursue the matter further, so that I might in due course put proposals to colleagues. My officials have now discussed the background with yours and those of DOE and it has been agreed that the most appropriate way forward is that I should write to you setting out how I propose that the problem should be tackled. I envisage that the proposals in this letter, together with your response, should provide the basis for consideration of the matter by E(LF) colleagues - and I hope that arrangements can be made for a meeting to be held if necessary by around the end of January.

It is quite clearly our policy as a Government that we should have level playingfields, in relation to business rates throughout Great Britain. I therefore propose that I should take powers to control rate poundages in Scotland with a view to bringing them progressively into line with the UBR. It may be politically tolerable for some modest contribution towards the costs of this to be made by community charge payers but there are clear limits to the amount of this. I propose therefore that the bulk of the excess, reflecting in the main higher valuation practices in Scotland which we expect to be improved by harmonisation, should be met by grant on a basis which we will have to consider year by year in the context of successive grant settlements. A more detailed discussion of the background and of these proposals is set out in the Annex to this letter.

I have already written to Nicholas Ridley on 8 December with proposals for the inclusion of certain Scottish community charge, valuation and rating provisions in the forthcoming Local Government Housing Bill, on a basis which would provide sufficient scope for that Bill to be amended to include these rate poundage proposals. I would simply emphasise at this stage that this approach in relation to the scope of the Bill does not in

any way pre-empt your consideration and that of E(LF) colleagues of my proposals in this letter. It is, however, important that we should clarify the position soon, so that any necessary detailed preparatory and drafting work can be done. I would therefore be grateful for an early response to this letter.

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

*Yours ever,
Malcolm*

MALCOLM RIFKIND

THE BURDEN OF BUSINESS RATES IN SCOTLAND

Proposals by the Secretary of State for Scotland

The need for action

1. The reform of business rates is based on the principle that in future businesses should pay the same rates wherever they are geographically situated and that their liability should not depend on the spending policy of their local council.

2. Official discussions have now taken place and it is common ground that Scottish business ratepayers are "overpaying" rates by comparison with their counterparts in England, by about £300 million per annum, equivalent to about 25% of non-domestic rates. This calculation is based on our present expectations of the average increases in rateable values north and south of the Border at the 1990 Revaluation. These estimates are to some extent dependent on the progress made towards harmonisation of valuations, and if this leads to a lower increase in rateable values in Scotland the excess rate burden (compared with changing the UBR poundage on these lower valuations) would correspondingly increase.

!! 3. The factors which lead to the excess rates burden in Scotland interact in a complex way, and no single explanation is possible. Local authority expenditure per head is higher in Scotland than in England, very largely because of technical differences in the coverage of local authority services and because needs in Scotland are higher. There is evidence that rateable values for at least certain classes of industrial and commercial premises are higher in Scotland: for example it is estimated that the additional rateable value attributable to higher decapitalisation rates is around £80 million, while higher valuations in the commercial sector may account for additional rateable value of up to £200 million. Downward harmonisation in these areas alone, other things being equal, would reduce the rates paid by business by around £200 million. With business rateable values higher than they should be, and with a higher level of grant than in England, Scottish local authorities have been able to maintain their level of spending while keeping the burden on domestic local taxpayers at broadly the same level per adult as it is in England.

4. Scottish business ratepayers are well aware of the scale of the excess burden, and are exerting very strong pressure on us to do something about it. They can claim, with some justification, that our policies now amount to treating rates as a national business tax and that our commitment to 'level playing fields' in taxation matters means that Scottish businessmen should be taxed on the same basis as those south of the Border. They have been mollified by the commitment which the Prime Minister gave in a recent letter to the President of the Glasgow Chamber of Commerce, which has been widely quoted in Scotland, in which she said:-

'In our Green Paper, 'Paying for Local Government' we made clear that we saw advantage in moving to a common non-domestic poundage in all areas and since then our policies have been aimed in that direction. We have no intention of going back on what we have set out to accomplish'.

5. The problem cannot be disposed of on the argument that local authorities in Scotland overspend. Certainly their level of spending is higher per head than in England and Wales and there is no doubt that

their expenditure policy contributes substantially to the burden to which I have referred. But on the basis of our national policy it does not follow that Scottish business ratepayers should therefore pay more. The introduction of the UBR means that the rates burden on businesses will no longer be influenced by the spending policies of the local authorities where they are located: for example, business ratepayers in the major cities in the north of England can expect to see a reduction in their rate poundages, as well as in many cases a relative reduction in their rateable values, notwithstanding the continued high-spending of the local authorities there. We clearly need to put business ratepayers in Scotland on an equal footing and the proposals in this paper are designed to achieve that.

6. In future pressure on high-spending local authorities throughout Great Britain will come through the mechanism of accountability created by the community charge system.

The way forward

7. The objective of my proposals is to move over the next few years to a position where business ratepayers in Scotland are paying rates on the basis of harmonised rateable values and at the same rates poundage as in England.

8. The process of harmonisation of valuation is already well underway as a result of discussions between the Inland Revenue Valuation Office and the Scottish Assessors' Association. The indications we have are that for the bulk of properties, which are valued on the basis of rental evidence, a very substantial degree of harmonisation should be achieved in the 1990 Revaluation. There is also reason to hope that some of the other conspicuous gaps between practice north and south of the Border will be closed. For example we are considering prescribing a uniform structure of decapitalisation rates for use in contractor's principle valuations. I do not rule out the possible need to make further use of the powers I have taken to prescribe principles of valuation if significant continuing gaps are identified which it would be possible to close before 1990, and it is clear that further steps will be necessary after 1990, for example in relation to the valuation of Plant and Machinery. But I am confident that, in a period of a few years following the 1990 Revaluation it will be possible to achieve an acceptable degree of harmonisation of valuation.

9. Turning now to rate poundages, it is clear that a straightforward Scotland-only UBR would not help solve the problem. It would mean higher rates for the low-rated areas in Scotland, although their rate levels at present are already generally higher than south of the Border. It would be inconsistent with the commitment the Prime Minister has given. The establishment of a GB-wide rates pool, with a common rate poundage would be one solution. This would, however, require complex legislation and result in a considerably higher level of rates in England and Wales. It would be a logically more consistent solution in the longer term, but does not seem attractive in the immediate future.

10. Instead I propose to modify the power of prescription of rate poundages in the Abolition of Domestic Rates Etc (Scotland) Act 1987 in order to be able to prescribe the poundages for each local authority. This would enable me, over a transitional period of several years, to adjust poundages so that they gradually moved into line with the English UBR. Plainly, those with the highest poundages at present would move

downwards more rapidly but I think there would be benefits for all, or virtually all ratepayers as a result of this process and that it would ensure a smooth transition to a position where my objectives are met.

11. I envisage that this process would start in 1990-91, the year in which the Revaluation takes effect, and would be completed by the time the 1995 Revaluation takes effect. It would thus broadly match the transitional arrangements which I expect will be made south of the Border to phase in the combined effects of revaluation and the introduction of the UBR for those ratepayers facing large losses or large gains.

12. I think it would be appropriate to make the necessary legislative provision in 1988-89, and I suggest that the most appropriate vehicle would be the forthcoming Housing and Local Government Bill. This will extend to Scotland, and will contain provisions about community charge, rating, valuation and grant matters. I am in touch separately with the Secretary of State for the Environment and the Lord President about the Scottish contents of that Bill. I would not envisage an immediate announcement of my plans since quite a bit of work will be required on the detail, but have it in mind to make a statement at an appropriate time in the first half of this year, at which point I would bring forward the relevant Government amendments to the Bill.

Finance implications

13. My proposals imply a reduction over a period of five years in the contribution which business ratepayers will be making to local authority expenditure in Scotland of the order of £300 million. This section of the paper discusses how we might deal with that.

14. In principle there are 3 possible directions in which we might move:-

14.1 We could hope for a corresponding reduction in local authority spending. I am anxious to see that happen, but we must recognise that is hardly feasible. I, and George Younger before me, have fought hard to bring Scottish local authorities into line through grant penalties, sometimes draconian and much more substantial than in England, and by forcing through rate reductions whenever we could do so without serious risk of legal challenge. All that has achieved is to stabilise spending in volume terms. We must hope that, in time, the pressures imposed by the community charge will help. But it is unlikely that local authority attitudes will change significantly in the short term: and the scale of reduction that would be required to remove the excess burden of £300 million is not going to be achievable in practice;

14.2 We could shift the burden to community charge payers. If we were contemplating transferring the whole of the £300 million of additional expenditure the average community charge in Scotland would have to increase by approximately one-third. This does not seem acceptable and would be incompatible with the UBR in England and Wales where the cost in high spending authorities will not fall on local community charge payers.

14.3 We could redistribute the existing total of Revenue Support Grant to Scotland's benefit. This would imply a single uniform business rate applying to the whole of Great Britain. In effect this would afford extra revenue to Scottish authorities at the direct expense of non-domestic ratepayers in England and Wales. I can

understand the reasons why this approach is likely to be unacceptable to colleagues.

15. The following paragraphs outline my own basic approach to this problem.

16. Clearly, a proportion of high spending by Scottish authorities is justified by reference to such factors as Scottish high levels of social deprivation and the high costs of providing services in sparsely populated areas. An additional problem in Scotland, which has been insufficiently quantified previously, is the lower level of rating resources available to Scottish local authorities. Further information on the details of this will become available as 1990 approaches. I therefore start from the position that some level of higher spending, but not the present level, can be justified, and that we must compensate for the effects of the low level of rating resources.

17. In the light of these factors I propose a balanced approach. Although it does not follow from the logic of this approach to business rates that the costs in areas of high spending authorities should fall on the community charge payer, it might be politically tolerable for some modest contribution by the community charge payer to meeting the overall problem to be phased in over a period of years. The main point of the cost of reducing excess business rate payments would however have to come from grants. This will mean that in successive negotiations with the Treasury over the amount of Revenue Support Grant in Scotland in the coming years I shall want to illustrate the likely impact of particular grant settlements on community charge payers. In this way it should be possible to moderate the burden on business ratepayers and I will have to look to the the Treasury to temper the grant settlement to produce results which we can jointly defend to community charge payers.

Conclusion

18. I propose:

18.1 That I should take statutory power to prescribe the levels of local authority rates, with a view to moving in the period 1990-1995 to a situation where Scottish and English ratepayers are paying a common rate poundage;

18.2 That officials should be asked to work out the details of this approach, with a view to an announcement being made at an appropriate time in the first half of this year, at which point the necessary amendments would be introduced in the Housing and Local Government Bill.

18.3 That the cost should be met largely by grant, on a basis to be considered in the context of the annual RSG settlements, with some modest further contribution from community charge payers.

SCOTTISH OFFICE
January 1989

LOCAL GOVT

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