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PRIME MINISTER

THE BURDEN OF BUSINESS RATES IN SCOTLAND
[Letter of 9 January from the Secretary of State for Scotland to the Chief Secretary, Treasury, and subsequent Correspondence]

DECISIONS

1. It is generally accepted that Scottish businesses face a larger burden of rates than businesses in England and Wales. Latest estimates suggest that, after the 1990 revaluations in all three countries, the excess burden may be some £300m. Mr Rifkind's letter seeks E(LF)'s agreement to move towards a uniform business rate (UBR) in Scotland, eventually to be at the same level as in England.

2. The main issues for decision are:

i. whether to move to a UBR in Scotland at the English level. The Green Paper "Paying for Local Government" said that the Government saw advantage in moving over time to a common business poundage in all areas. You have since given assurances, widely quoted in Scotland, that that remains the Government's intention;

ii. how the cost of reducing Scottish rates should be met. Mr Rifkind proposes a mix of additional Exchequer grant and a modest contribution from community charge payers in Scotland. Mr Major may suggest either that the cost be found within the Scottish block or that there should be a much more radical harmonisation of the local government finance system covering Scotland, England and Wales. The latter would have implications for business rates and community charge levels throughout Great Britain;

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iii. timing. Mr Rifkind seeks agreement to take the necessary powers in this Session's Housing and Local Government Bill, and to phase in a UBR in Scotland between 1990 and 1995. If Mr Major suggests more radical harmonisation, this would imply a longer timescale.

BACKGROUND

In 5 limited stages

3. The uniform business rate (UBR), with a common rate poundage in each local authority area, is being introduced in England from 1 April 1990. A separate UBR is being introduced on the same date in Wales. But the UBR is not at present being introduced in Scotland: from 1 April 1989 the existing rate poundage in each Scottish local authority area will be frozen, subject to uprating for inflation.

4. Rating revaluations are also due to come into effect throughout Great Britain on 1 April 1990. Great efforts are being made to harmonise the basis of rating valuation between Scotland and England and Wales. But rate poundages will be rescaled to maintain the same overall rate burden in each country in real terms. This will maintain the existing relative position between Scotland, England and Wales. As it happens, the English and Welsh UBR, poundages are expected to be very close (around 34-35p on recent estimates). But the average Scottish poundage will be higher. It is currently estimated that Scottish businesses may be paying some £300m more than if the English UBR poundage applied to them on the new valuations.

5. E(LF) discussed the possibility of setting a common UBR poundage across the whole of Great Britain on 19 December 1985 (E(LF)(85)7th Meeting chaired by Lord Whitelaw). Mr Younger, then Scottish Secretary, argued for this approach. However other members of E(LF) were not prepared to see this achieved at the expense either of increased Exchequer grant or a higher UBR in England and Wales. They noted that local authority spending in Scotland was much higher than that elsewhere, and suggested that if Scottish rate poundages were to be set at the levels for England, the cost ought to borne either by reductions in spending or by community charge payers in Scotland.

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6. The Scottish chapter of the Green Paper "Paying for Local Government" said that the Government saw advantage in moving in time to a common non-domestic poundage in all areas. But it recognised that this required harmonisation of valuation practice. Until that was achieved, the Government proposed to retain the existing pattern of rate poundages in Scotland, subject to uprating for inflation. That was the basis of the legislation in the Abolition of Domestic Rates Etc (Scotland) Act.

MAIN ISSUES

Case for a common UBR in Scotland, England and Wales

7. There are good arguments in favour of moving to a common UBR throughout Great Britain:

i. equity. The rationale of the new local government finance system is that the impact of the spending decisions of local authorities should fall on the community charge payers who can vote them in or out of office. There is no justification within this system for a higher level of business rates in Scotland, although the level of spending there is higher (about 30% per adult above English levels);

ii. economic efficiency. A higher level of business rates in Scotland would tend to deter companies from setting up there, and distort decisions on business location.

8. These arguments underlay the statement of the Government's views in the Green Paper. You reiterated the Government's intention to move to a common UBR poundage in two letters to the Glasgow Chamber of Commerce last summer (copies attached). You made it clear however that this would need to be achieved over a realistic timescale; and that it would be necessary to tackle the high level of spending by Scottish local authorities which had resulted in the high level of rates.

9. For all these reasons, E(LF) will no doubt agree that the Government must in time move to a UBR in Scotland, with a rate poundage similar to those which apply in England and in Wales. But

this could be achieved in a number of ways: E(LF) will need to decide how to move towards harmonisation, and over what timescale.

Harmonisation restricted to non-domestic rates only

10. The most straightforward approach would be to seek harmonisation of non-domestic rates only. That would leave substantial differences in relation to other aspects of the new financial regime. For example, Wales would continue to benefit from a much higher percentage of Exchequer Grant than England, with Scotland in an intermediate position. Community charges in Wales would as a result be well below English and Scottish levels (around £150 compared to around £250 on 1988/89 figures).

11. This approach would require a reduction of around £300m in Scottish business rate bills. That money could in principle be found from one or more of three sources:

i. from Scottish community charge payers. £300m would be equivalent to about £80 on the annual charge, bringing it to perhaps £330 on average on 1988/89 figures;

ii. from the Exchequer in the form of an even higher grant rate for Scottish local authorities. But we understand that the Chief Secretary is likely to make it clear that he is not prepared to find new money;

iii. from businesses in England and Wales, through a higher uniform rate poundage designed to raise the same Great Britain total as now. £300m would add about 3% to business rates south of the border. But this approach would be strongly contested by both Mr Ridley and Mr Walker.

A fourth alternative would be cuts in spending by Scottish local authorities. But as Mr Rifkind says, these are unlikely to be achieved in the short term, even with the accountability pressures of the community charge.

12. Mr Rifkind has suggested that the cost of harmonisation should be met by more Exchequer grant (by implication new money), plus a modest contribution from Scottish community charge payers (I understand he may have in mind about 25% of the total). The Chief Secretary may be prepared to countenance a solution of this sort, provided Mr Rifkind finds any extra grant within the Scottish block.

13. This approach might just be acceptable to Mr Rifkind. Community charges for Scotland in 1989/90 seem likely to be lower than has been anticipated in the past, perhaps about £250 on average, broadly the same cash figure implied by 1988/89 figures for England. Furthermore the Scottish charge covers sewerage, which is part of water charges in England. So on a fair comparison Scottish charges seem likely to be lower than English ones, despite the much higher level of spending in Scotland. Mr Rifkind may therefore have the scope to find rather more than he implies from this source over a run of years without pushing community charges to unreasonable levels. He might be able to find the remainder of the £300m from offsetting savings elsewhere in Scotland.

14. You may wish to ask Mr Rifkind to explore whether he could meet the costs of harmonisation within the Scottish block. If so, this may be the best solution.

Harmonisation across a wider front

15. We understand that the Chief Secretary may suggest that an alternative approach would be a more radical harmonisation of the new local government finance regimes throughout Great Britain. This would have substantial implications:

i. there would be a common UBR, which would meet Mr Rifkind's problem;

ii. there would be a common rate of Exchequer grant: the advantage currently enjoyed by Wales and (to a lesser extent) Scotland would be removed;

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iii. there would be a common system of needs assessment. This would almost certainly show substantial overspending in Scotland, where spending per adult is around 30% above the average level in England. All the excess would have to be met by the community charge, pushing Scottish charges much higher than the £250 now in prospect;

iv. there would be a common community charge for spending at need. This would mean charges in Wales at around the English level of £250, not the £150 now in prospect.

16. This approach has a certain logic. But it would be a major departure from the basis in which the Government has approached the introduction of the community charge regime to date. It would impose a degree of harmonisation between Scotland and England which has not been sought in the past; and between England and Wales which has not been sought since the existing local government finance system was established in 1980. It would seriously disrupt the smooth introduction of the new system For these reasons, E(LF) will probably not be attracted by this approach.

Timing

17. Mr Rifkind wants to start the process of harmonisation in 1990/91, when the UBR is to be introduced in England and Wales, and to complete it by 1 April 1995, when the next but one revaluation is due. To achieve this he wishes to take a short enabling power in Mr Ridley's Housing and Local Government Bill this Session. You will want to seek the business managers' views on the Parliamentary implications. But subject to that, this timetable may be acceptable provided Mr Rifkind is willing to meet the costs within the Scottish block.

18. But there is also a case to be made for a more cautious timetable. The process of harmonising Scottish valuations with those in England and Wales will not be completed in the 1990 revaluation. For example, differences will remain over the treatment of plant and machinery. If harmonisation is completed on the basis of 1990 valuations, there may need to be another painful adjustment in 1995 when better harmonisation is achieved. A longer timescale would

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avoid this, and provide more time to resolve the issues, particularly if Mr Rifkind is not prepared to find the costs of harmonisation within his block. E(LF) may therefore want to consider a slower timetable, perhaps aiming for harmonisation by the time of the third revaluation in 2000.

VIEWS OF OTHER MINISTERS

19. The Secretaries of State for the Environment and for Wales are both likely to give some support to the aim of eventual harmonisation. But they will be most concerned to ensure that it is not achieved at the expense of any reduction in Exchequer grant or increase in either community charges or business rates in England or Wales. The Secretary of State for Social Security will be concerned about any implications for housing benefit or income support. If part of the cost of harmonisation is met by Scottish community charge payers that will mean a larger benefit bill, for which he has made no provision. However most of the impact would be felt beyond the current Survey period, even on Mr Rifkind's timetable. The business managers may be concerned about the implications of adding yet further provisions to the Housing and Local Government Bill.

HANDLING

20. You will want to ask the Secretary of State for Scotland to introduce his paper. The Chief Secretary, Treasury might be invited to speak second. The Secretaries of State for the Environment and for Wales will wish to comment, as will the Secretary of State for Social Security.

RJW.

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Cabinet Office
20 January 1989