F CC BKP F

PRIME MINISTER 25 January 1989

E(LF) 26 JANUARY 1989: THE BURDEN OF BUSINESS RATES IN SCOTLAND

This is a long-standing problem whose solution has to balance public expenditure constraints against the political situation in Scotland.

The Government has repeatedly acknowledged the problem and said its aim is to ensure that Scottish business is treated fairly compared with elsewhere in Britain. But commitments on timing have been carefully avoided. A solution is now important because:

(a) the disparity has been quite well hidden up to now because of the wide variation in rates burdens up and down the country, but next year's English unified business rate will throw a spotlight on it. If nothing is done it is bound to cause great difficulty in Scotland in 1990/91 and could be a damaging election issue there;

(b) expectations have been aroused by letters you wrote last summer to the Glasgow Chamber of Commerce (attached). These had wide publicity, and have been interpreted as giving a strong indication that, over a realistic timescale, a solution will be found and implemented.

Malcolm Rifkind will stress the political angle: Scottish business is the Government's main, if not only, real ally north of the border and at all costs must not be alienated by a failure to act. The Chief Secretary will not dissent from this, but will argue strongly on public expenditure grounds against funding a rates reduction through additional Exchequer grant, which could be of the order of £300m. He will also emphasise that this would increase still further grant per head in Scotland, already 65% more than England. He will urge instead that Scotland funds its own solution by changing priorities within its existing expenditure block and/or by increasing the Scottish community charge.

Putting the whole burden on the community charge is unrealistic and would add to public expenditure because so many people in Scotland will get rebates. Yet average Scottish community charges are expected to be relatively low compared with England - about £300 for high-spending authorities like Lothian compared with forecasts of up to £600 for inner London boroughs. So there is scope for a modest contribution from Scottish community charges and Malcolm Rifkind is prepared to concede that.

He has not commented as yet on the prospects for switching funds from other parts of the Scottish block. This will almost certainly be difficult, but if he is prepared to give some ground here and get something from the community charge, it ought to be possible for the Treasury to show some flexibility given a 1995 timescale.

The other angle is getting Scottish local authority spending down. Scottish rates are high because spending is high. You highlighted this in your letters. The main weapon here is the community charge itself. On a 1995 timescale there must be scope for reducing spending to lessen the scale of the problem.

Malcolm Rifkind is also seeking powers in the Housing and Local Government Bill (being introduced next month) to control the level of each authority's poundages in order progressively to reduce Scottish business rates to English levels. Nicholas Ridley is content with this in principle and it is a necessary part of an effective solution. But the timing of an announcement on this is very important because it will be a firm signal that the Government is taking the action you promised. It is thus essential that financial details are fully sorted out by then. The Treasury will resist powers being introduced first with the prospect of them having to concede additional grant by the mere existence of the powers and political pressure for them to be used quickly.

CONCLUSION

In short, there should be a good prospect of steady progress towards a solution, in line with the commitments you have given, through a variety of means which minimise public expenditure implications. The aim should be reasonable equity by 1995 - something which can be defended to Scottish electors in 1991 or 1992. Absolute equivalence between Scotland and England is not practicable and is not being sought.

JH.

JOHN MILLS