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POLICY - IN CONFIDENCE

The Rt Hon Norman Lamont MP
Chief Secretary
HM Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

2 November 1990

Dear Norman,

1991-92 AEF FOR SCOTLAND: RSG/NDRI SPLIT

My officials have reported to me the discussions which they have had with yours about the above matter.

I recognise that Chris Patten and David Hunt have announced that their 1990-91 NNDR figures should be fully indexed by the September RPI figure of 10.9%. In considering the basis for indexation in Scotland I have to have regard to the policy of moving to a common level of NNDR between Scotland and England which I agreed with John Major with the strong support of the Prime Minister and the fact that the excess burden on Scottish ratepayers is very much larger in real terms than was anticipated when decisions on this policy, including its funding, were taken last year. Instead of the £250-£280m which we estimated, the gap seems likely to be of the order of 60-80% higher than anticipated, mainly because the revaluation multiplier in England was significantly in excess of that forecast. While it might have been possible to allow for a slightly larger gap by extending the timescale over which harmonisation was achieved, the scale of the difference is such that it is quite impossible to put a date on equalisation of poundages and as a result the credibility of the policy is now suspect.

Against this background, I regard your officials' proposal that 1990-91 Scottish poundages should also be indexed by the September RPI figure as totally incompatible with our commitment to gradually reduce the gap. The 1990-91 English NNDR is, of course, 34.8p. The average poundage in Scotland is 57.4p. If we apply the same indexation factor in both countries the effect will be to widen in cash terms the gap our policy is designed to close. And the level of contributions (£40 million (subject to GDP deflator indexation) per annum) envisaged in my agreement with John Major would come nowhere near that required to narrow, never mind bridge, the gap over any reasonable timescale. In other words, unless the real value of contributions to reducing the gap is increased

substantially, then it is unlikely to reduce significantly in real terms before the next revaluation in 1995, which would clearly be a nonsense.

There is already strong criticism from the Scottish CBI and business community about the rate of progress towards a unified business rate and I would be in a totally indefensible position if the effect of our decisions in relation to 1991-92 was to further widen the gap. I must therefore seek your agreement to an approach which enables us to claim that real progress is being made towards convergence of poundages north and south of the Border. I recognise that there could be embarrassment for Chris Patten and David Hunt if an indexation factor lower than 10.9% was to be applied overtly to Scottish poundages and I therefore do not press for that option.

What I do propose - given that our policy is specifically aimed at convergence of poundages - is that poundages in both England and Scotland should be increased by the same absolute amount, namely 3.8p. Even then the average Scottish poundage (before next year's UBR reduction) would still be 61.2p. But we would be able to claim, after the UBR reduction which I propose below, that real progress was being made towards our policy objective.

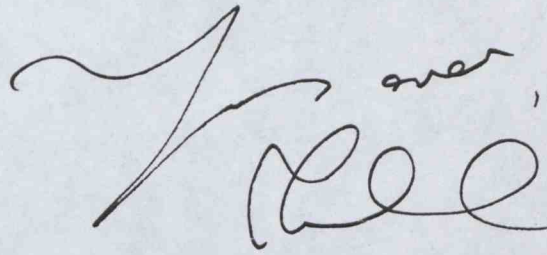
The above is my preferred option, but an alternative would be to apply the full indexation factor not to the estimated Scottish NDRI yield of around £1265 million in the current year but to the original target of £1189 million. The justification for this is that the over-shoot of around £70 million arises mainly because it is now clear that, in fixing 1990-91 poundages, we under-estimated the rateable value increases following the 1990 revaluation to a much greater extent than was the case south of the Border. But for this estimating error Scottish poundages would have been set at a lower level than was the case. I do not think that Scottish business should be required to pay the cost of this for more than one year.

I very much hope that you can agree to the first or, failing that, the second of these proposals. Full indexation of 1990-91 Scottish poundages would be totally incompatible with our agreed policy and would produce a result which would be extremely damaging politically. The timetable for reaching a decision on this matter is now extremely tight and, if necessary, I think we should meet - or at least speak on the telephone - as soon as possible.

For the longer term I think we need to review the timetable in which a common level of NNDR is likely to be established between England and Scotland, and possibly Wales as well, given that, as I understand it, the Welsh NNDR is currently in excess of the English NNDR. It would be helpful if this could be completed before we come to take decisions on AEF and rate poundages next year and I would be grateful for your agreement to officials looking at this subject, with a view to reporting to us by next June at the latest.

Finally, I think that there might be presentational advantage in increasing the 1991-92 UBR reduction from the £42 million in our present plans to a slightly larger sum. In line with the scope for slight flexibility in our agreement, I hope that you will be prepared to contribute 25% of the additional amount. I am willing to fund the remaining 75% from my Block.

I am copying this letter to the Prime Minister, Chris Patten and David Hunt, and to Sir Robin Butler.

A handwritten signature in black ink, appearing to read 'Malcolm Rifkind', with the word 'over' written above the main signature.

MALCOLM RIFKIND