2131/20

CONFIDENTIAL

MP

FROM: A TURNBULL
DATE: 13 JANUARY 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Mr Anson
Mr Kemp
Mr Hawtin
Mr Odling-Smee
Mr Sedgwick
Mr Gilmore
Miss Peirson
Mr Potter
Mr Gieve
Mrs R Butler
Mr Deaton
Mr Fellgett
Mr G C White
Mr Kidman

Ch/
Content to send paper to Mr Ridley and possibly discuss

MPW 13/1

TREATMENT OF NATIONAL NON-DOMESTIC RATE

One of the many issues which needs to be resolved as part of the exercise to introduce a new planning total is the treatment of the national non-domestic rate. Having looked at the way this is to be set up and operated, divisions in the Treasury believe the amount and distribution of the NNDR is almost entirely a central government responsibility and the payments made should come within the planning total. This reflects the fact that the statutory framework determining who pays the NNDR, the upper limit on the NNDR poundage, and how the NNDR proceeds are to be distributed to local authorities reflects central government policies; and that, once the statutory framework is set up central government has more discretion than local authorities.

2. A further argument, not reflected in the attached paper, is that it would be convenient to have the NNDR in the planning total as it should go up little more than in line with inflation. This will, to some extent, offset the RSG which realistically we must expect to rise somewhat faster.

3. DOE officials have resisted this proposal strongly. They are anxious not to present the new regime as "centralist" and hence wish to avoid showing it as leaving 75 per cent of local authorities' income under central government control. (We think they are whistling in the dark.)

4. They argue that "statute" is something independent which binds central government as well as local authorities. (In a sense it does, but what is in statute reflects central government policies.)

5. Attached is a paper which sets out why the Treasury believe the payments financed by the NNDR should be in the planning total. It has been discussed with DOE officials but not agreed with them. Indeed, they disagree with a lot of it. They would have preferred a different paper which set out all the arguments on both sides including each side's rebuttal of the other's points. We felt this would have put our case less clearly.

6. We suggest that you now send it to Mr Ridley, with an offer to talk to him informally about it. This is better than seeking a reply in writing which will no doubt be drafted by his officials. Although we feel strongly that the balance of argument supports our conclusion, this is an issue which needs to be handled carefully with DOE. We have hitherto been successful in securing their support for the idea of a new planning total, and we will want to retain that in the discussions that lie ahead with other departments.

AT

A TURNBULL

CONFIDENTIAL

pse type final for Ch/ signature

M.

DRAFT LETTER FOR THE CHANCELLOR TO SEND TO SECRETARY OF STATE FOR THE ENVIRONMENT

NEW PLANNING TOTAL: NATIONAL NON-DOMESTIC RATE (NNDR)

In the joint note by our officials on the timetable for consultations on the new planning total, which I sent to the Prime Minister last month, a number of classification issues were identified, which need to be resolved in order to complete the preparatory work. The first of these is the treatment of the national non-domestic rate (NNDR) and I attach a paper prepared by my officials which has been discussed, but not agreed, with your officials.

I am firmly convinced tht the payments to local authorities (LAs) financed by NNDR proceeds should be included within the new planning total. The main point of changing the planning total, when the Community Charge is introduced in England and Wales, is to distinguish expenditure for which central government will be responsible and accountable from expenditure which will be at the discretion of local authorities. Under the new system of local government finance, the structure of non-domestic rates, the level of the NNDR poundage and the distribution of NNDR proceeds will be determined at the national level; and it will be central government - not local authorities individually or collectively - which will be accountable for the policy.

The main framework will be set in statute but within that framework, central government can exercise some discretion over the amount of NNDR revenue through the power to override indexation of the NNDR poundage. By contrast, LAs will have no powers over the poundage and only a minimal discretion over the rate base, through discretionary reliefs which will themselves be subject to central government regulation. Nor will local authorities have any responsibility for the level of receipts from the NNDR pool.

I believe that, given our basic rationale for changing the planning total, it would be very difficult to defend to the Treasury and Civil Service Committee and others, the alternative treatment of excluding these payments from the new planning total. And I am sure it would help to allay the concerns expressed earlier by the Prime Minister as well as any public criticisms of the proposed changes, if some 75% of LAs current expenditure continued to be included within the planning total.

In discussion between officials, I understand your officials argued that these payments should be excluded from the planning total so that they could be classified as local authorities own resources.

I appreciate their presentational anxieties and in particular their concern that including the payments within the planning total could be adduced as evidence that the NNDR will not continue to be an independent and hence reliable source of revenue to LAs. But it seems to me that we would be perpetuating a fiction, if we adopt a presentation showing NNDR monies as being part of local authorities self-financed resources.

We also need to keep this rather esoteric classification issue in perspective. I do wonder whether the classification of these payments, which of itself has no financial or policy significance to an individual LA, will add to, let alone provoke, adverse political reaction to the reform of local government finance from the local authority associations (LAAs) and others - particularly since the Bill is likely to be well on its way through Parliament by the time we inform the LAAs of our proposals.

I therefore hope that on consideration you will feel able to support my conclusion that the payments to LAs financed by NNDR proceeds should be within the new planning total. I would be very happy to discuss this further, if you feel that would be helpful.

[N.L]

CONFIDENTIAL

TREATMENT OF THE NATIONAL NON-DOMESTIC RATE IN THE NEW PLANNING TOTAL

Non-Domestic Rates

Under the provisions of the Local Government Finance Bill, uniform non-domestic rate poundages will be set for England and Wales (separately) as from April 1990. Different arrangements will apply in Scotland - see below.

2. Local authorities will continue to be responsible for collecting non-domestic rate revenue; but the revenues will be pooled centrally (in a notional fund) and redistributed to each local authority as a flat rate NNDR payment per adult. The notional fund is to be in balance, taking one year with another.

3. The amount of revenue collected and redistributed annually will depend upon the aggregate non-domestic rateable value base and the non-domestic rate (NNDR) poundage. Separate poundages for England and Wales in 1990 will be set by the Secretaries of State for the Environment and Wales respectively, following consultation with the Treasury. Thereafter the NNDR poundages for each country will be indexed annually to the rate of inflation; but there will be a power for the Chancellor to override the indexation and set a lower rate for the NNDR poundage.

Public Expenditure Planning Total

4. Under the Treasury proposals for a new public expenditure planning total to be presented in Public Expenditure White Papers (PEWP) as from 1990, the classification of local authority current expenditure would be changed. At present all LA current spending is within the public expenditure planning total. In future, it is intended that the planning total would comprise

central government's own expenditure; the grants it provides to local authorities; an appropriate measure of local authority capital spending; the external finance of public corporations; and a Reserve. Current expenditure which local authorities (LAs) finance themselves through the Community Charge would - like certain other public expenditure items such as debt interest - be outside the planning total but still within General Government Expenditure (GGE). The Government will continue to express its medium term objective for reducing public expenditure spending as a proportion of national income in terms of GGE which combines both central and local government spending.

5. The basic distinction between what is to be included in, and what is excluded from, the planning total rests on the degree of responsibility placed on central government for delivering that expenditure within public expenditure plans. Where central government is responsible for and can largely determine the amount of spending, the item is included in the new planning total. The corollary is that, only when an item of expenditure is largely outside the responsibility of central government and is in large part determined by some external agent - such as spending financed by the Community Charge, where individual local authorities have a genuine measure of disretion - should the item be excluded from the new planning total.

6. This paper considers how the payments to LAs financed by NNDR revenue should be classified. The Treasury proposes that these payments should be classified in the same way as central government grant to LAs and therefore within the planning total. DOE officials consider that such expenditure should be classified as LA expenditure financed by authorities' own resources and therefore outside the planning total.

The case for including spending financed by NNDR proceeds within the planning total

7. In the Treasury view, the critical issue in deciding on the classification is whether the payments to LAs financed by NNDR revenue are the responsibility of and can be determined by central government; or whether they are subject to significant influence by another agent ie the local authorities. On this basis the arguments for including payments to LAs financed by NNDR revenue within the planning total are as follows.

i) NNDR payments to local authorities will be very largely determined by central government, principally through statute. The size of the payments will depend upon the NNDR revenue from what is essentially a hypothecated tax; and an upper limit on the rate of that tax is set by statute with the Chancellor able to substitute a lower rate. LAs by contrast will have no powers over non-domestic rate poundages.

ii) Rateable values, which together with the poundage determine the NNDR bill for each business, are set in accordance with general valuation principles by the Valuation Office, a part of central government. The rules for determining which businesses are liable to pay non-domestic rate will be set in broad terms by statute and in detail by central government regulations. LAs have a very limited power over who is to pay and how much - it extends only to discretionary relief cases like charities; and even then the effects of that discretion on NNDR payments will be subject to regulation set by central government.

iii) Central government has decided that the NNDR poundage will be capped in real terms; it follows that the amount of NNDR revenue and hence NNDR payments to LAs will have been very largely determined by central government. Consistent with the philosophy of the new planning total, the classification of the payments within public expenditure totals should reflect that high degree of central government responsibility.

8. In practice the NNDR payments may well be seen by local authorities as very like central government grant. Indeed the payments they receive are likely to be an aggregate of Revenue Support Grant entitlement plus any net NNDR entitlement - NNDR revenue raised minus NNDR payments due.

9. The Treasury therefore concludes that the payment to LAs financed by NNDR revenue should be included in the new planning total. Once the proposed statutory framework has been set, central government can exercise some, in practice probably limited, discretion over the size of NNDR revenue, through the Chancellor's power to override indexation of the NNDR poundage. By contrast the local authorities have only a tiny discretion over the NNDR rate base (through the powers to grant certain reliefs, powers that are subject to central government policy regulation). In aggregate the payments to LAs can therefore largely be determined by central government and are not subject to significant influence by the local authorities.

10. The CSO will in due course determine how NNDR revenue and payments are to be classified in the national accounts. The issue can only be put to them formally when the details have been finalised. They have yet to discuss the details with DOE; but their preliminary view is that NNDR revenue would score as central government revenue and NNDR payments as central government spending. And that would indicate that the payments to LAs financed by NNDR proceeds should be included within the planning total. It is highly desirable to avoid introducing differences in the classification of such an important expenditure item as between the Public Expenditure White Paper and the National Accounts.

The case for excluding spending financed by NNDR proceeds from the planning total

11. DOE believe that the classification of the NNDR payments should describe, and be consistent with, the proposed relationship between central and local government in the Local Government Finance Bill. They consider that expenditure financed by NNDR payments is not significantly like central government grant but rather more akin in nature to that financed through the Community Charge. On this basis, payments to LAs financed by NNDR revenue should be excluded from the planning total. DOE's case rests on two arguments:-

- that NNDR payments are unique; they are not like other expenditure items or programmes within the planning total; and their size is not at the discretion of central (or local) government but rather is set by statute;

- that NNDR payments are local authorities "own money" and should be classified alongside local authorities other own resources (the Community Charge) and hence outside the planning total.

12. In part, the first of these arguments is about the different nature of the items to be included in the new planning total. It is true that NNDR payments are an intermediate payment, rather than final expenditure in the sense, for example, that spending on the MOD programme is. But this intermediate status is common to a number of items to be included in the new planning total such as EFLs and, of course, central government grant to LAs. The NNDR payments are not unique in this sense.

13. The first argument also seeks to draw a distinction between what is within central government control and what is prescribed by statute. Whereas central government distributes resources amongst other programmes within the planning total according to its own priorities, it will have no such discretion on the size of the NNDR payments. Rather Government will be following the mechanical rules set out in statute which determine NNDR revenue and hence NNDR payments.

14. The Treasury takes the view that the way statute provides for the structure of non-domestic rates,the level of the NNDR poundage and the distribution of NNDR proceeds is a reflection of central government policy. Furthermore within the statute central government does in fact have some discretion on the size of the payments - because the NNDR poundage may be set below its previous real level in any year. And there are many other programmes within the new planning total where the amount of expenditure is largely determined by statute, with discretion for central government only at the margin. A close parallel might be drawn with Social Security uprating; some benefits are statutorily indexed, while for others the Government can opt not to uprate in full against inflation in any year.

15. The second argument is essentially about how the relationship between central and local government is perceived and presented. In the Green Paper "Paying for Local Government" (PLG) it was made clear that the NNDR payments were to be regarded as local authorities' own money. Paragraph 2.4 states:-

> "Local authorities for their part will continue collectively to enjoy the full benefits of the non-domestic rate."

Considerable emphasis was placed on this in public presentation, particularly when the Green Paper was first circulated.

16. More recently, as work on the Local Government Finance Bill evolved, this line of argument has been developed further: the PLG system is increasingly being presented as the only viable alternative policy to centralisation of services - that is the transfer of local authority functions to central government. It can be argued that it would undermine this policy stance if the Government were to classify some 75% of LA expenditure as financed by money received from central government.

17. On the other hand, in the Treasury's view, the Government has already publicly acknowledged (eg the Financial Times article on November 16 by the Minister of State for Local Government) that the bulk of LA expenditure will be financed from sources outside LAs own control ie central government grant and NNDR. The meeting of E(EP) on the future arrangements for teachers pay decided on the composition on the management side of the proposed Teachers Negotiating Group by reference to the fact that 75% of LA current expenditure is controlled by central government. And Mr Baker has used this argument to defend that arrangement in public.

Scotland

18. In Scotland there will not be a uniform business rate for an interim period, pending harmonisation of valuation practice with England and certain other developments. During this period, which is expected to last until around 1995, the pattern of non-domestic rate poundages in different local areas in Scotland will be frozen, and then allowed to rise no faster than the RPI (subject to the Chancellor's override). Non-domestic rates income will therefore be kept by each locality rather than pooled throughout Scotland. In place of pooling, Revenue Support Grant will be distributed to offset the distribution of rates income, to achieve a distribution of grant and rates income together which matches the arrangement in England. Rateable values in Scotland will not be determined by the Valuation Office but by Assessors who are local officers.

19. On the one hand, it can be argued that since central government will have responsibility for increases in rate poundages and hence total NNDR revenue in Scotland, it is similar to the position in England and Wales. Central government can determine and control total non-domestic rates. The counter-argument is that LAs in Scotland will keep non-domestic rate revenue themselves (though it may be "equalised" away under the RSG system). In this sense it is their "own money" like the Community Charge.

20. Whichever way non-domestic rates are treated would lead to anomalies. One option, if it were agreed that NNDR payments should be within the planning total in England and Wales, would be to apply the same treatment in Scotland - on grounds of comparability once harmonisation is achieved throughout Great Britain. But the issues are not clear cut. And the views of the CSO will need to be sought, bearing in mind that harmonisation is unlikely to be achieved until around 1995.

Conclusion

21. In the Treasury's view the arguments based on the underlying philosophy of the new planning total point to including payments to LAs financed by NNDR proceeds within the planning total: the payments are very largely the responsibility of central government and not subject to significant influence by local authorities individually or collectively. DOE consider that the arguments about the perceived relationship between central and local government on the new local government financial system suggest that these payments should be excluded from the planning total. They consider this is more consistent with what has been said so far about the place of the NNDR in future arrangements and in particular about their independence from close central government control.

22. It is important not to exaggerate the wider, as distinct from the internal Whitehall, importance of the issue. In particular, it is necessary to judge whether the way NNDR payments are classified within the PEWP and the national accounts will have much impact on the perception of the new structure of local government finance. Clearly local authority associations and their contacts in Parliament may use it as a supporting debating point in attacking the Government's proposals on local government finance. But it is equally clear that, for example, the CBI and LA associations are already well aware that only about a quarter of local government current expenditure will be financed through local authorities own powers to raise revenue; Ministers have already stated that in public. It is to the Government, not local authorities that the CBI are directing their complaints about the quantum and distribution of business rates. And it is central government which will have to account to Parliament and the electorate for both the level of the NNDR and the distribution to LAs of NNDR proceeds.

23. It must be doubted whether such an esoteric issue as the accounting treatment of the NNDR payments within PES plans would add to, let alone provoke, adverse political response to the proposals from local authorities. Of itself, the accounting treatment has no financial or policy importance to an individual local authority. Moreover, by the time the proposed make-up of the new planning total is revealed to local authority associations, the revised structure of local government finance may well have been approved by Parliament.

24. The Treasury believes that the NNDR payments to LAs should be included within the planning total.

H M Treasury

ps3/37T

CONFIDENTIAL

cc Chief Secretary
Mr Anson
Mr Kemp
Mr A Turnbull
Mr Odling-Smee
Mr Sedgwick
Mr Gilmore
Miss Peirson
Mr Hawtin
Mr Potter
Mr Gieve
Mrs R Butler
Mr Deaton
Mr Fellgett
Mr G C White
Mr Kidman

MW His Ps will chase TL 12/2

CHASE ANSWER FROM RIDLEY TOMORROW. BF TL

~~PSTP~~

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

Thanks she called me about it

pl BF ~~17/2~~.

15 January 1988

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

MW very shortly SM, 17/1

Pse chase Ridley's office. When can we expect a reply & BF 18/2
mpw.

Dear Nick

In the joint note by our officials on the timetable for consultations on the new planning total, which I sent to the Prime Minister last month, a number of classification issues were identified, which need to be resolved in order to complete the preparatory work. The first of these is the treatment of the national non-domestic rate (NNDR) and I attach a paper prepared by my officials which has been discussed, but not agreed, with your officials.

I am firmly convinced that the payments to local authorities (LAs) financed by NNDR proceeds should be included within the new planning total. The main point of changing the planning total, when the Community Charge is introduced in England and Wales, is to distinguish expenditure for which central government will be responsible and accountable from expenditure which will be at the discretion of local authorities. Under the new system of local government finance, the structure of non-domestic rates, the level of the NNDR poundage and the distribution of NNDR proceeds will be determined at the national level; and it will be central government - not local authorities individually or collectively - which will be accountable for the policy.

The main framework will be set in statute but within that framework, central government can exercise some discretion over the amount of NNDR revenue through the power to override indexation of the NNDR poundage. By contrast, LAs will have no powers over the poundage and only a minimal discretion over the rate base, through discretionary reliefs which will themselves be subject to central government regulation. Nor will local authorities have any responsibility for the level of receipts from the NNDR pool.

I believe that, given our basic rationale for changing the planning total, it would be very difficult to defend to the Treasury and Civil Service Committee and others, the alternative treatment of excluding these payments from the new planning total. And I am sure it would help to allay the concerns expressed earlier by the Prime Minister as well as any public criticisms of the proposed changes, if some 75 per cent of LAs' current expenditure continued to be included within the planning total.

In discussion between officials, I understand your officials argued that these payments should be excluded from the planning total so that they could be classified as local authorities' own resources.

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We also need to keep this rather esoteric classification issue in perspective. I do wonder whether the classification of these payments, which of itself has no financial or policy significance to an individual LA, will add to, let alone provoke, adverse political reaction to the reform of local government finance from the local authority associations (LAAs) and others - particularly since the Bill is likely to be well on its way through Parliament by the time we inform the LAAs of our proposals.

I therefore hope that on consideration you will feel able to support my conclusion that the payments to LAs financed by NNDR proceeds should be within the new planning total. I would be very happy to discuss this further, if you feel that would be helpful.

Yours
Nigel

NIGEL LAWSON

CONFIDENTIAL

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Public Expenditure Planning Total

4. Under the Treasury proposals for a new public expenditure planning total to be presented in Public Expenditure White Papers (PEWP) as from 1990, the classification of local authority current expenditure would be changed. At present all LA current spending is within the public expenditure planning total. In future, it is intended that the planning total would comprise

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5. The basic distinction between what is to be included in, and what is excluded from, the planning total rests on the degree of responsibility placed on central government for delivering that expenditure within public expenditure plans. Where central government is responsible for and can largely determine the amount of spending, the item is included in the new planning total. The corollary is that, only when an item of expenditure is largely outside the responsibility of central government and is in large part determined by some external agent - such as spending financed by the Community Charge, where individual local authorities have a genuine measure of disretion - should the item be excluded from the new planning total.

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ii) Rateable values, which together with the poundage determine the NNDR bill for each business, are set in accordance with general valuation principles by the Valuation Office, a part of central government. The rules for determining which businesses are liable to pay non-domestic rate will be set in broad terms by statute and in detail by central government regulations. LAs have a very limited power over who is to pay and how much - it extends only to discretionary relief cases like charities; and even then the effects of that discretion on NNDR payments will be subject to regulation set by central government.

iii) Central government has decided that the NNDR poundage will be capped in real terms; it follows that the amount of NNDR revenue and hence NNDR payments to LAs will have been very largely determined by central government. Consistent with the philosophy of the new planning total, the classification of the payments within public expenditure totals should reflect that high degree of central government responsibility.

8. In practice the NNDR payments may well be seen by local authorities as very like central government grant. Indeed the payments they receive are likely to be an aggregate of Revenue Support Grant entitlement plus any net NNDR entitlement - NNDR revenue raised minus NNDR payments due.

9. The Treasury therefore concludes that the payment to LAs financed by NNDR revenue should be included in the new planning total. Once the proposed statutory framework has been set, central government can exercise some, in practice probably limited, discretion over the size of NNDR revenue, through the Chancellor's power to override indexation of the NNDR poundage. By contrast the local authorities have only a tiny discretion over the NNDR rate base (through the powers to grant certain reliefs, powers that are subject to central government policy regulation). In aggregate the payments to LAs can therefore largely be determined by central government and are not subject to significant influence by the local authorities.

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20. Whichever way non-domestic rates are treated would lead to anomalies. One option, if it were agreed that NNDR payments should be within the planning total in England and Wales, would be to apply the same treatment in Scotland - on grounds of comparability once harmonisation is achieved throughout Great Britain. But the issues are not clear cut. And the views of the CSO will need to be sought, bearing in mind that harmonisation is unlikely to be achieved until around 1995.

Conclusion

21. In the Treasury's view the arguments based on the underlying philosophy of the new planning total point to including payments to LAs financed by NNDR proceeds within the planning total: the payments are very largely the responsibility of central government and not subject to significant influence by local authorities individually or collectively. DOE consider that the arguments about the perceived relationship between central and local government on the new local government financial system suggest that these payments should be excluded from the planning total. They consider this is more consistent with what has been said so far about the place of the NNDR in future arrangements and in particular about their independence from close central government control.

22. It is important not to exaggerate the wider, as distinct from the internal Whitehall, importance of the issue. In particular, it is necessary to judge whether the way NNDR payments are classified within the PEWP and the national accounts will have much impact on the perception of the new structure of local government finance. Clearly local authority associations and their contacts in Parliament may use it as a supporting debating point in attacking the Government's proposals on local government finance. But it is equally clear that, for example, the CBI and LA associations are already well aware that only about a quarter of local government current expenditure will be financed through local authorities own powers to raise revenue; Ministers have already stated that in public. It is to the Government, not local authorities that the CBI are directing their complaints about the quantum and distribution of business rates. And it is central government which will have to account to Parliament and the electorate for both the level of the NNDR and the distribution to LAs of NNDR proceeds.

23. It must be doubted whether such an esoteric issue as the accounting treatment of the NNDR payments within PES plans would add to, let alone provoke, adverse political response to the proposals from local authorities. Of itself, the accounting treatment has no financial or policy importance to an individual local authority. Moreover, by the time the proposed make-up of the new planning total is revealed to local authority associations, the revised structure of local government finance may well have been approved by Parliament.

24. The Treasury believes that the NNDR payments to LAs should be included within the planning total.

H M Treasury