24/1/DJS/2328/12

FELLGETT → CST 26/2

CONFIDENTIAL

I agree. As we see it, key considerations here are that Mr. Ridley's proposal for a significant temporary premium on the business rate (perhaps about 10% in 1990-91) would turn gainers into losers and be seen as a government impost on business, thus generating pressures for Exchequer finance.

FROM: R FELLGETT

DATE: 26 February 1988

1. MR HAWTIN

2. CHIEF SECRETARY

The Ridley option is (a) unacceptable to HMT (b) involves a breach of faith with the business community over the level of the NNDR, or at least makes so clear as to be a hard-won [illegible] [illegible]. Moreover it [illegible] the hard-won E(LF) decision [illegible] the question [illegible] the (arguable) percentage [illegible] shortfall [illegible] when we have all the facts.

cc Chancellor
Financial Secretary
Sir P Middleton
Mr Anson
Mr H Phillips
Mr Monck
Mr Scholar
Mr Turnbull
Mr Luce
Mr Potter (o/r)
Miss Sinclair
Mr MacAuslan (o/r)
Mr Tyrie
Mr Call
PS/Inland Revenue
Mr Calder (IR)
Mr Jaundoo (IR)
Mr Morgan (CVO)

NON-DOMESTIC RATE TRANSITION

This submission offers advice on Mr Ridley's minute of 24 February to the Prime Minister. It also covers his letter of 27 January to the Chancellor, and Mr Cope's letter of 18 February to Mr Howard, copied to the Chancellor. The letters of 16 February from the Institute of Directors and 17 February from the Small Business Bureau to the Financial Secretary are also relevant.

2. This correspondence concerns the transition from present business rates bills to those after 1990, following both a rating revaluation of business properties and a uniform business rate in England (and separately in Wales) in place of independent rate poundages set by individual local authorities. It also concerns the information available to assess the transition and final new rates bill for business property.

3. I recommend that you:

(i) oppose Mr Ridley's latest proposals for the transition, because they seem untenable without additional Exchequer finance;

(ii) but indicate that, if a decision can be delayed, the VO and IR could help estimate the likely effects of the revaluation in order to devise a more acceptable transition (although this could not easily be done quickly and would not provide the information that Mr Ridley has actually asked for).

Transition

4. E(LF) on 30 April 1987 decided to phase-in the largest gains and losses from the revaluation and move to a National Non-Domestic Rate (NNDR) together, over 5 years, by imposing a percentage limit on the annual change in individual rate bills. The percentage then envisaged was 20% or 25%, although no figure was included in the Prime Minister's summing-up.

5. Mr Ridley's minute of 25 June to the Prime Minister implied, without explaining that it was a new proposal, a different method of phasing-in the changes. Rather than offset the cost of phasing for losers by an equivalent phasing for gainers, he suggested "setting an NNDR poundage in 1990-91 slightly above the average poundage for 1989-90" (in real terms, ie before annual increases in the NNDR indexed to the RPI). In other words, the cost of phasing for losers would be paid for by a supplement on the NNDR for all others, phased out as losses are phased in. Compared to the E(LF) decision this penalises modest gainers and losers in 1990-91, to allow large gains to come through more quickly. This asymmetric approach has been incorporated in the Local Government Finance Bill.

6. Mr Ridley now proposes to limit the annual increase for losers to 15% (also in real terms). He suggests that the "slight" addition to the average poundage for 1990-91 will, in fact, be about 10%. In effect, businesses whose bills would rise by more than 15% from the revaluation and NNDR would be limited in 1990-91 to 15%; businesses whose bills were due to rise between 5% and 15% would also face increases of 15%; and those whose bills were due to fall or rise by up to 5% would face increases 10% higher than they would otherwise expect. The 10% surcharge is, however, a very uncertain figure: there is no adequate evidence on which

to base it and the DOE officials have worked from highly speculative assumptions that we cannot check.

7. I doubt if a surcharge of around 10% for all business ratepayers apart from significant losers would be accepted by the business community. It would be difficult to avoid the Exchequer paying. (The precedent of Scottish revaluation relief grant is worrying). I estimate the full cost of a 10% surcharge would be about £¾ billion in 1990-91, and reducing thereafter.

8. There are broadly three options for a self-financing transition:

(i) Revert to the E(LF) decision of broadly equal phasing for gainers and losers. This could be defended as treating both equally; losers would have time to adjust and gainers would see regular gains each year. The disadvantage is that gainers, including much of manufacturing industry and many businesses in the North and inner cities, who regard themselves as having waited since 1975 for fairer rates, would have to wait longer for their full gains. It would also require amendments to the Bill.

(ii) Stick to the asymmetric phasing favoured by Mr Ridley, but with a much larger annual limit on increases than 15% (indeed probably much larger than 25%) so the surcharge would be small enough - one or two percent - to be tenable. This has the opposite pros and cons.

(iii) Amend the Bill to provide wide powers to prescribe the transition by regulation, and leave both options above open.

9. At this stage, we have little evidence on which to base a final decision (see below). Although business would no doubt welcome the certainty of a firm, detailed, announcement, they should recognise the advantages of an equitable transition based on a reasonable knowledge of gainers and losers. It would

therefore be best not to fix on a numerical limit, like Mr Ridley's 15%, without knowing the consequences.

10. Indeed it would be advisable to leave all options open (the third alternative) until we can model gainers and losers and pick the most saleable option. This would not be welcome to Mr Ridley, who wishes to offer assurances now to the various business interests. However, it may be defensible to say that the Government cannot take final decisions in the absence of information about the effects of revaluation and NNDR; all representations from business will be taken into account; and regulations to implement a decision will, of course, be subject to the scrutiny of Parliament. The IoD letter implies that a decision should depend on information about gainers and loser.

11. If political pressures nevertheless require an announcement of a numerical limit on annual charges within the next few months, broadly symmetric phasing of 20-25% a year, as E(LF) envisaged, now looks more defensible than Mr Ridley's option. The higher the figure, the faster the overdue revaluation will come into effect.

12. (We have considered, and rejected, more complicated options involving phasing the move to NNDR at a different rate to the effect of the revaluation. In logic, the revaluation, which will reflect the cumulative effect of economic changes since 1973, should be introduced quickly, while the changes in rate poundages/due to the NNDR could be phased-in more slowly. But in practice, business (especially small business) is unlikely to distinguish the two elements of their rates bills, and simply see both types of change as a consequence of Government policy.)

<u>Information</u>

13. We have discussed Mr Ridley's letter of 27 January with the VO and IR statisticians. Two types of information could be made available but these would, for technical reasons, depend on different surveys of the likely effects of the revaluation. (The effect of the simultaneous move to NNDR on rates bills can be estimated without difficulty.) The two are:

(i) the effect on average rates bills for various types of property for different geographical areas. This is what Mr Ridley and Mr Cope want, and would update the earlier VO study which the Chancellor decided should be given only very limited circulation within Whitehall.

(ii) the effect on the overall distribution of rates bills. This is lacking at present, and would be needed to model overall gainers and losers to pick the best option for transition.

14. Mr Ridley and Mr Cope want to rebut the more alarmist stories being spread by some representatives of small business in the retail trade. The business community also has a legitimate interest in information about the effects of revaluation, which could help them plan their construction and location decisions. Wider dissemination of the information would equally help with the civil service relocation exercise.

15. On the other hand, publication of the VO estimates, which will be seen as a more authoritative study than stories from business groups and private valuers with their own axes to grind, might actually increase the alarm of the business community. (A sample of the more alarming figures from the earlier VO study is attached.) It would also be unfortunate to reassure business, on the basis of a sample study, and then find that the impact on some property from the actual revaluation was quite different. On balance, I suggest you continue to resist publishing VO estimates of the revaluation, although something may have to be conceded in due course.

16. In any case, the priority should be to provide information on which to base final decisions about transition. This could be done, but the exercise would be more cost effective and relevant if the VO undertook the sample valuations necessary as part of the actual revaluation exercise beginning in July. This would also allow IR statisticians to undertake the analysis after their work on the Finance Bill has passed.

17. This would allow time for the Government's decisions on transition to be announced in the Autumn, still some 18 months before local government finance reform comes into effect in April 1990.

Other points in Mr Ridley's minute

18. You will wish to agree that the NNDR should not automatically be indexed to something less than the RPI, which would in practice require increases in central taxation to make up the difference in Exchequer grant. I also suggest that you agree with Mr Ridley that it would be wise to take powers to have a transition after the 1995 and subsequent rating revaluations. They may not be needed (although I expect some transition is almost inevitable) but it seems prudent to take such powers.

19. Mr Ridley finally agrees with your earlier letter of 17 July, and proposes to retain a duty on local authorities to consult with business. This will no longer be linked to the setting of local business rates, but dropping such a requirement would give the wrong signals.

Conclusion

20. I therefore recommend that you respond to Mr Ridley's two letters and that from Mr Cope in terms of the attached draft. (Depending on the outcome of this correspondence, we will provide separate responses to the IoD and SBB letters.) Mr Ridley has asked for comments by lunchtime on Monday 29 February.

21. This advice has been agreed with the Inland Revenue (including the Valuation Office), FP and IAE.

22. We understand that the Cabinet Office are briefing the Prime Minister that the symmetric option originally favoured by E(LF) looks more attractive than Mr Ridley's proposal and that a decision is not needed immediately.

Robin Fellgett

R FELLGETT

CONFIDENTIAL

DRAFT LETTER FOR THE CHIEF SECRETARY'S SIGNATURE

To: Secretary of State for the Environment

NON-DOMESTIC RATE TRANSITION

Thank you for copying to me your minute of 24 February to the Prime Minister. I am also responding to your letter of 27 January to Nigel Lawson, and John Cope's letter of 18 February to Michael Howard which he copied to Nigel, about the availability of information on the likely effect of the revaluation and move to a uniform business rate.

I agree with you that it would be prudent to take powers to apply a transitional scheme to the 1995 and subsequent valuations (which might be broadly drafted to allow us maximum flexibility at the time); that we cannot afford to add automatically to the substantial benefit that business can expect from the indexation of business rates to the RPI; and (as I suggested earlier) that we should retain the duty on local authorities to consult with business, to avoid giving the wrong signals.

I am, however, worried about the position we now seem to have reached in your latest proposals for managing the transition after 1990. We agreed in E(LF) in April 1987 that major losses and gains, from the change to a National Non-Domestic Rate and from the revaluation, would be phased in over 5 years. Although no figure was settled, we then envisaged a maximum increase in rates bills (in real terms, ie before allowing for annual indexation to the RPI) of 20% or 25%, with corresponding phasing for gainers so the transition would be financially neutral. As I understand it, your latest proposal involves phasing for losers (but not gainers), offset financially by a supplement to the NNDR in 1990-91 of around 10% for everyone apart from significant losers. This is far from the option touched on in your minute of 25 ~~July~~ June to the Prime Minister of a "small" supplement. I doubt if it would be attractive to business. We should therefore consider amending the Bill to revert to the E(LF) decision. If we do, and there is no choice but to announce a figure shortly, I would favour as high an annual limit as possible, closer to 25% than 15%, to phase in the long-overdue effects of revaluation as fully as we can before 1995.

However, I am not clear that we have yet to take a final decision. Although you and John Cope have suggested collecting one form of information about the likely effects of revaluation, I understand that a very different form of survey would be needed to assess the likely distribution of gainers and losers, so we can consider a final decision on transition on the basis of some firm information about the likely range of effects on business. That survey would be best done in the initial stages of the revaluation itself, which will begin in July.

I therefore see merit in announcing that we will amend the Bill to take broad regulation making powers to determine the transition in the light of evidence actually gathered in the course of the revaluation. We would hope to make an announcement in the Autumn after studying the results of the survey. This could be presented as a response to the concerns of industry - the Institute of

Directors have, for example, written to Norman Lamont to suggest discussions of phasing for which, they say, the crucial point to know is the distribution of increases. We would, of course, assure business that their representations will be taken into account, and assure Parliament that they will have an opportunity to consider our conclusions when they come to the regulations.

I am copying this letter to the Prime Minister, to colleagues E(LF), and to Sir Robin Butler.

[JM]

COMBINED EFFECT OF REVALUATION AND NNDR

1. GAINERS BY MORE THAN 50%

	Shops	Offices	Factories
LONDON		Southwark 51% (10.2%)	City 50% (10%) Haringey 54% (10.8%)
NORTH		Newcastle 52% (10.4%) Leicester 64% (12.8%) Manchester 53% (10.6%)	Newcastle 62% (12.4%) Sunderland 58% (11.6%) Sheffield 60% (12%) Leicester 50% (10%) Sandwell 53% (10.6%) Wolverhampton 51% (10.2%) Liverpool 67% (13.4%) Manchester 51% (10.2%)

2. LOSERS BY MORE THAN 50%

	Shops	Offices	Factories
LONDON	City 66% (13.2%) Hammersmith 128% (25.6%) Kens & Chel 249% (49.8%) Wandsworth 102% (20.4%) Westminster 102% (20.4%) Barnet 53% (10.6%) Bromley 101% (20.2%) Croydon 81% (16.2) Redbridge 63% (12.6%) Richmond 106% (21.2%)	Kens & Chel 90% (18%) Wandsworth 60% (12%) Harrow 60% (12%)	Hammersmith 63% (12.6%) Kens & Chel 194% (38.8%) Bromley 53% (10.6%) Harrow 99% (19.8%)
SOUTH	Cambridge 66% (13.2%) Basingstoke 103% (20.6%) Bournemouth 81% (16.2%)	Basingstoke 87% (17.4%) Reading 83% (16.6%) Slough 82% (16.4%) Thamesdown 50% (10%)	Slough 52% (10.4%)

BF 2/3

FROM: MOIRA WALLACE

DATE: 29 February 1988

PS/CHIEF SECRETARY

cc PS/Financial Secretary
Sir P Middleton
Mr Anson
Mr H Phillips
Mr Monck
Mr Scholar
Mr Turnbull
Mr Luce
Mr Potter
Miss Sinclair
Mr MacAuslan
Mr Fellgett
Mr Tyrie
Mr Call
PS/IR
MR Calder - IR
Mr Jaundoo - IR
Mr Morgan - CVO

NON-DOMESTIC RATE TRANSITION

The Chancellor has seen Mr Fellgett's minute of 26 February, and Mr Ridley's minute of 24 February. He has commented that Mr Ridley's option is unacceptable to the Treasury, and involves a breach of faith - or as near as makes no difference - with the business community over the level of the NNDR. He has also commented that it is intolerable that the hard-won E(LF) decision should be overturned. The question is what the (symmetrical) percentage should be, and that can only sensibly be determined when we have all the facts.

MPW.

MOIRA WALLACE