Local Government Group

LG Group Executive
10 February 2011

Item 2

Local Government Resource Review

Purpose of report

For direction

Summary

This paper provides an update on work on the issues raised by the forthcoming Local Government Resource Review, in particular the potential for local authorities to retain business rates.

Recommendation(s)

Members are asked to provide a steer on the broad objectives that the Association should pursue through the Local Government Resource Review.

Action

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Local Government Resource Review

Background

1 Last December's Group Executive considered a paper and presentation on the potential for achieving, through the government's planned Local Government Resource Review, greater financial autonomy and flexibility through the retention of business rates locally. As members will recall, the government's intention to review this area was announced in the October 2010 Local Growth White Paper. The White Paper said that the review offered 'a significant opportunity to consider a range of options to provide genuine incentives for local economic growth through the business rates regime, and to equip local authorities with the tools to support that role'. It added that the review would need to consider a number of important issues, including in particular how to fund councils where locally raised funding would be insufficient to meet budget requirements.

2 There is no doubt that the prospect of change in this area is very much to be welcomed. At best, the outcome of the review could be to secure a number of major changes to local government finance that have long been sought by the Association. The challenge for us is to achieve that kind of top-end outcome in this area, given the history of previous reviews that have produced little real change. In this context, the government's expression of determination to translate review into action is encouraging.

3 The discussion in December covered a diverse range of perspectives on the relevant issues, including concerns that resources should be distributed on the basis of need; doubt that all areas of the country enjoyed local economic conditions conducive to using business rates based incentives to support local economic growth; desire for a genuine incentive enabling councils to keep full control over additional business rates income; and a variety of view on how such arrangements might work in two-tier areas and for single service authorities.

4 This would also provide the framework which would enable Tax Incremental Finance (TIF) schemes, where councils can borrow against a future uplift in their business rates base in particular defined areas to help fund major infrastructure development. The LGA has done work with member councils and the government on the introduction of TIF. Further progress on this is, in the view of the government, dependent on the Resource Review. For member authorities, it is very important that real progress is made in this area, and quickly.

5 The December discussion concluded with members authorising further work on the issues raised by the Resource Review, including consultation with member authorities; and emphasised that the LG group should not take a lobbying position in favour of any one manner of redistributing business rates.

6 Since then, effort has not surprisingly been concentrated (both in the LGA, in member authorities and in the Department for Communities and Local Government) on the immediate issues raised by the Local Government Finance Settlement. The Department has yet to initiate the Local Government Resource Review formally or publish terms of reference for it. Nevertheless, some issues have emerged that were not covered in December's discussion but are germane to the review, and it will be helpful to have members' views on these issues at an early stage.

Scope of the review

7 There has been political debate about the scope of the review. This is a key point. As was clear from members' discussion in December, a review that is solely focused on business rates could produce an outcome that left councils in general less dependent on government grant than is now the case, but many questions would be left open about funding mechanisms for authorities where locally raised funding is insufficient. These questions raise some sharp political issues. Most formula grant is currently redistributed business rates; it follows that a reform of business rates would be difficult to carry out without a fundamental review of the current 'four block model' method of distributing formula grant. This provides an opportunity to reform what is largely seen as a non-transparent system.

8 The ongoing political debate has also highlighted wider issues about the links between business rates reform and moves towards greater local financial devolution and autonomy, for example reform to the council tax, the introduction of new local taxes (or perhaps the assignment of existing ones) and relaxation of some important restrictions on local government.

9 We can see this tension at work in the lobbying we have done on the issue of capitalisation. At present, the Association's call for greater financial freedom is being rejected not because it is unnecessary or unsound but because the way in which the government is seeking to control public spending as a whole, including spending funded locally through council tax, means that spending decisions taken locally count against the government's overall fiscal numbers. Therefore, supposedly in the interests of controlling the overall public spending numbers, the Treasury imposes constraints on actions that, from a local perspective, simply represent sound and sensible management of local resources.

10 It follows that business rates reform on its own, without wider reform of the framework for control of public spending, would not solve and might even increase this kind of central-local tension. Superficially, being allowed to retain the proceeds of extra business rates and extra council tax from local growth seems attractive. But how real is that freedom if it is constrained by overall decisions on limiting public spending? On the opposite side of the coin, and reflecting some of the concerns expressed in the December meeting, what assurances would government be prepared to give to areas that did not enjoy high economic growth, that falling or stagnant local revenues would not be allowed to pull a locality into a downward spiral of decline?

11 There is the related question of council tax discounts and other reforms to the council tax, aside from a full council tax revaluation which is clearly ‘off limits’ for the government. This links with consideration of how localisation of council tax benefit can be introduced, bearing in mind the 10% cut in subsidy from 2013 announced in the Spending Review.

12 Members’ views on the scope of the review and, in particular, its interaction with wider questions about local financial autonomy and spending control, would be appreciated in order to shape the Association’s further work.

Management of financial risk

13 At present, a number of risks relating to business rates yield are managed by government and, therefore, do not give rise to potential financial risk for local authorities. There are four principal risks of this nature.

14 First, government manages the ups and downs of overall fluctuations in the yield from business rates through the business rates pool. The pool must balance over a number of years but does not need to balance in any one year. At times, the pool has been significantly in deficit, with the government being prepared to distribute more money to local authorities than is likely to be raised from business rates and allowing this deficit to be recovered over a period of years. The amounts involved here have been in the low £ billions, quite significant in relation to the overall level of yield.

15 Second, government manages risk arising from inaccuracies in local authorities’ estimates of likely business rates income. Differences between authorities’ estimates of what is likely to be raised, and what is actually raised, result in adjustments in the amounts paid in to the business rates pool. These adjustments are treated by the government as ‘annually managed expenditure’, which means that it, and not local authorities, takes the risk. In recent years the differences arising have been in the hundreds of millions of pounds.

16 Third, government manages risk arising from changes to the structure of business rates, for example through the impact of revaluation or through new reliefs. The impact of revaluation or changes to reliefs can be extremely difficult to predict at individual local authority level, and revaluation in particular – given the principle that it does not affect the total national yield raised – can lead to significant changes in local yield that are outside individual authorities' control. Having said that the question of how revaluation should be managed when business rates are localised is a very real one.

17 Finally, because authorities get redistributed business rates rather than retaining their own locally raised business rates, the government bears risks associated with local economic contraction, such as the bankruptcy of a large local employer.

18 Under a system of local retention of business rates, it is possible that management of at least some of these kinds of risks would sit squarely with individual local authorities. Authorities are well used to managing financial risks, and most do so very effectively, but we could be talking here about a substantial risk transfer from central to local government. This risk could be mitigated by either

- continuing with a centrally managed, but smaller, business rates pool; or
- arrangements for the risk to be managed collectively by local government.

19 It would be helpful to have members' initial views on authorities' appetite for operating in this very different kind of environment, and on the kind of financial relationship with government that we might want as a consequence.

Recommendations

20 Members are asked for a steer on the broad objectives that the Association should pursue through the Local Government Resource Review, in the light of these emerging issues. This will shape our further consultation with member authorities.

Financial Implications

21 This is core work for the finance team and all work is contained within existing budgets.