Local Government Group

LG Group Executive
19 May 2011

Item 2

Local Government Resource Review

Purpose of report

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For discussion / direction.

Summary

This paper outlines the questions posed in the LGA's consultation on the LGRR and other issues arising from our discussions with government.

Recommendation
Members are asked to provide a steer on the approach the LGA should take in providing a sector-wide response to the review.

Action
Group Finance Director

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Background

1. In March, CLG published terms of reference for the first phase of its Local Government Resource Review (LGRR). The review's main focus is the relocalisation of business rates; a second phase of the review is planned which would look at community budgets.

2. This phase of the LGRR is due to conclude in July. The LGA has published strategic and detailed technical consultation papers on the LGRR and is seeking responses by 20 May 2011. We currently anticipate that government will publish its own consultation paper at the end of May / early June.

3. Ministers, including the Prime Minister and Deputy Prime Minister, have made bold statements that the LGRR should lead to meaningful reform of local government funding, with a much higher proportion of local spending genuinely financed locally. If that is what we want to see, it is vital that as a sector we think collectively about how to achieve it, and find ways of managing potentially competing interests within the sector without those internal issues reducing councils' collective influence on government decision-making. We should also consider how we can most effectively influence the business voices that remain sceptical about fiscal devolution.

Key issues: LGA consultation paper

4. The LGA consultation paper considers which - if any - features of the current system we should retain and the principles that must underpin a reformed system of business rates.

5. In calling for the relocalisation of business rates, the LGA and councils have consistently cited a number of current problems. In the current system: councils are financially dependent on central government, with only marginal control over their income, and there is no direct financial incentive for them to seek to stimulate economic growth. The current system is overly-complex and opaque, and there is widespread dissatisfaction with the formulae that are used to model councils' needs.

6. However, the current model does attempt to ensure that there is a fair redistribution of rate income among all councils and create stability from year to year. Because that is done through a pool held by the government, it means the national Exchequer, and not individual councils, bears the financial risk from fluctuations in NNDR yield and forecasting errors.

7. The Group's consultation paper follows the Executive's recent steer by endorsing government's twin objectives for the review: reducing dependency on central government, and restoring the link between local prosperity and council financing. Additionally (and again in line with the Executive's view) it proposes that a reformed system must have a clear mechanism for ensuring that council resources keep pace with the costs incurred in providing services; a mechanism for managing fluctuations in NNDR revenue; and an approach which allows a manageable transition from the present system. In particular, the paper also asks how far authorities would be prepared to develop a sector owned approach to redistribution and collective arrangements to manage the risk of fluctuations.

8. Government's overriding objective in relocalising business rates is to create a financial incentive for councils to stimulate local economic growth. We are seeking authorities' views on the type of incentive mechanisms that will maximise the public benefit from relocalisation. Government has already indicated its support for Tax Increment Financing (TIFs), announced the creation of Urban Enterprise Zones and – in relation to council tax – created the New Homes Bonus, but there are other options. These include allowing authorities to vary business rates (via the multiplier) or local discounts and reliefs, or taking a local rather than a national approach to business rates revaluation.

9. Finally, the Group's paper asks whether councils wish to see the future financing discussion limited to the business rate, or – in line with the LGA's historic position – keep open the possibility of councils having a more diverse local revenue base available to them.

Other key issues

10. There are three other issues on which we would welcome the Executive's view.

11. First, it is likely that actual NNDR future revenue will significantly exceed the government's plans for formula grant. Without a change in the law, NNDR revenue must be redistributed to councils. The government's published figures suggest that NNDR revenue and formula grant will be roughly in balance in 2013-14 and that there will be £2.5 billion of surplus revenue in 2014-15. Higher than forecast inflation since the Spending Review means that these forecasts will probably be revised upwards. There are, in principle, three main possible uses for this surplus revenue:

    11.1 the government might find a route to snaffle the money (for example, by using it to fund a transfer of responsibility from central government to councils);
    11.2 the surplus could be used to cut the headline business rate in order to soften business opposition to re-localisation;
    11.3 the surplus could be allocated to councils in a revision to the spending review grant plans.

We suggest that the first option should be unacceptable. The most politically creative outcome might involve using the surplus to fund a combination of the second two. Members' views on the appropriate emphasis would be most welcome.

12. Secondly, the future treatment of new mandates (new burdens) is an extremely important issue. A localised system with no general grant from government would require a much more effective process for identifying and funding new burdens than the current one. Without a reformed and objective new burdens process – ideally incorporating some form of independent assessment – there is a risk that local taxpayers could bear the cost of a plethora of new initiatives.

13. Thirdly, the resource review opens the door to an important further debate about central control. The Treasury controls government departments' spending because it finances it, either by tax or borrowing. In a reformed local government finance system, in which revenue spending was financed by council tax, localised NNDR, and fees and charges, and council borrowing took place under the prudential code, it is not clear why the Treasury should still score locally-financed spending and borrowing within the control totals of the national budget and seek to manage them (other jurisdictions around the world do not carry a single public sector borrowing requirement on their Finance Ministry's books, for example). We therefore propose that we should use the resource review to open up this second-order debate about taking locally-financed spending out of central government's management.

Recommendations and next steps

14. Members are asked for a steer on our approach in the light of the comment above. Following the meeting, the finance team will continue to consult on LGRR with member authorities and pursue discussions with the Treasury and CLG. A draft response to the review, taking into account responses to our papers and the government's own consultation paper, will be brought to the Executive in June.

Financial Implications

15. None; all work will be covered within existing budgets.