COMMUNITIES AND LOCAL GOVERNMENT COMMITTEE: INQUIRY INTO THE GOVERNMENT'S BUSINESS RATES PROPOSALS

MEMORANDUM OF EVIDENCE FROM THE CHIEF ECONOMIC DEVELOPMENT OFFICERS SOCIETY (CEDOS)

Executive summary

We support the full retention of business rates at local level. However, with the accompanying phasing out of Revenue Support Grant and the transfer of additional responsibilities to local authorities, success in meeting the aim of driving local business growth will depend on the overall operational details.

So far the Government has given very little detail of how in practice business rate retention will work. Until the Government has issued details and what additional responsibilities will be placed on local authorities and any top-ups/tariffs policy, a full assessment of the effects of the scheme cannot be made.

Additional responsibilities suggested such as public health, housing benefit and financial support for older people, must be considered carefully in relation to the demography of local areas as well as overall trends, including an ageing population and business conditions.

Additional responsibilities must not be limited to the distribution of various forms of social benefit, however important, that are demand-led. The main focus must be on the fundamental purpose of 100% of business rate retention - to enable local authorities to drive local economic growth.

The key areas of additional responsibility must provide local authorities/areas throughout the country with the levers for driving business growth e.g. for skills development, business support, inward investment and infrastructure provision.

In two-tier areas, the nature of the additional responsibilities involved could change the make-up of funding fundamentally and will need to reflect the distribution of responsibility between the tiers.

On the definition of business rates, on balance the best way forward is to retain them as a property based tax but with provision for more local control and flexibility to enable more locally determined incentives for key business sectors.

For local authorities, the number of business rate appeals and the time they take to resolve are major issues, which are restricting the ability to invest in economic development and support business. There is a need to reform the appeal system.

The Government's proposed 'check, challenge, appeal' system aims to provide a quicker, clearer and more transparent service to businesses and greater financial certainty for local government but the proposed three-year period for business rate appeals is not consistent with speeding up the process.

Government must recognise the impact of the continuing cuts to local government funding. The Provisional Local Government Funding Settlement 2016-17 will result in further cuts on top of the very significant reduction in funding to local authorities of up to 40% in the last Parliament.

The cuts are affecting local authority services. Although councils have tried to protect spending on social care services, other service areas including economic development have seen larger reductions.

The National Audit Office reported a reduction in budgeted spend 2010/11 to 2015/16 in the economic development service area of -47%, one of the highest of individual service areas. In our 2015 survey of CEDOS members, around 70% reported economic development budget reductions over the previous two years.

With 100% business rate retention being accompanied by the phasing out of Government grants and £13 billion of additional responsibilities, there will be increased financial risk to local authorities due to the dependence on business rate income, which is a relatively uncertain and volatile income stream.

This underlines the importance of ensuring that local authorities have the necessary levers and devolved powers to pursue effectively policies and actions to promote economic and business rate growth in their areas.

It also highlights a need to ensure that business rate devolution is accompanied by protection measures to enable local areas to cope with, for example, the impact of major business closures and the impacts of revaluation periods and appeals.

At a broader level it supports the argument that local retention of business rates should be part of a wider approach to fiscal devolution to local areas. There is a case for giving local authorities control over a wider range of tax revenues including local retention of stamp duty.

The considerable degree of local authority dependence on business rate income will inevitably increase competition between local authorities and is also likely to result in a growing divergence between councils in terms of spending power.

Differences in outcomes are not just an issue of richer versus poorer areas but will also depend on local economic risk factors e.g. a relatively prosperous area could be at risk due to dependence on individual industries, a small number of large companies and individual large business rate generators.

In two-tier council areas, the implications of 100% retention of business rates will depend on local geography and economic circumstances. With the lack of any spatial planning framework at county level, the impact on land use planning could create starker contrasts between employment zones and residential areas.

The advantages of areas with better access to national transport networks and more significant brownfield land opportunities could result in investment being displaced from other areas and risk leaving them without a sustainable business rate base and in significant financial difficulty.

With the freedom to reduce business rates ‘to win new jobs and generate wealth’, there is a possibility not only of inter-area but also intra-area competition and a ‘race to the bottom’ in setting business rates. In some areas it could risk undermining consensus and agreed business rate pooling mechanisms.

It will be important to protect the less well-off authorities. This will require a fundamental reassessment of need prior to the start of the scheme. It will be equally important to make provision to enable response to changing circumstances including economic shocks affecting individual areas.

As yet there is no clarity on how any redistributive process will work. Whatever approach is taken, a balance must be struck to ensure that protection measures do not undermine the incentive to drive growth.

In the move to 100% business retention, it is essential for all areas, as far as possible, to have a level policy playing field on which to drive economic growth.

The intention that only areas with elected city-wide mayors will be able to add a premium to business rates to pay for new infrastructure, is fundamentally at odds with this. We believe this power should be available to all areas.

In Combined Authority areas, where there is an elected mayor, it will be essential to ensure support from the constituent authorities for which an agreed spatial vision/framework for growth will be important.

If the power is extended to all authorities, it emphasises further the importance of effective sub-regional working both within two-tier areas and between neighbouring authorities.

LEPs and other business representative organisations will have an important role in providing a business viewpoint and helping to achieve business involvement and support. However, local authorities already have a duty to consult with local businesses as part of their budget setting processes.

Likewise, local authorities have a long and proven track record of engaging with local businesses, through their economic development and statutory services. This engagement and consultation will become increasingly important given the greater role locally derived business revenues will have in council finances.

Introduction

1. This Memorandum of evidence is submitted by the Chief Economic Development Officers Society (CEDOS). The Society represents Heads of Economic Development in upper tier local authorities throughout England. Membership includes county, city and unitary Councils. The Society carries out research, develops and disseminates best practice, and publishes reports on key issues for economic development policy and practice. Through its collective expertise, it seeks to play its full part in helping to inform and shape national and regional policies and initiatives.

2. We welcome the opportunity to submit evidence to the Communities and Local Government Committee's Inquiry into the Government's proposals to allow local authorities to retain 100 per cent of the full stock of business rates by 2020 and to cut business rates, and for directly elected mayors to add a premium to business rates to pay for new infrastructure. In framing our submission we have consulted with our members across the country. Our evidence sets out our overall views and focuses on the particular points on which the Committee is seeking evidence.

CEDOS overall views

3. We support the full retention of business rates at local level. However, the Government has announced that this will be accompanied by the phasing out of Revenue Support Grant and the transfer of additional responsibilities to local authorities. The success of the change in meeting the aim of driving local business growth will very much depend on the overall operational details.

The details of the Government's proposals

4. The announcements on the Government's proposals that have been made so far have given only a broad picture of the changes that are to be made – that:

- from 2020 (by the end of the Parliament), local authorities will be able to retain 100% of business rates collected;
- the system of top-ups and tariffs which redistributes revenues between local authorities will be retained;
- the Uniform Business Rate will be abolished and any local area will be able to cut business rates as much as they like, "to win new jobs and generate wealth";
- only areas with elected city-wide mayors will be able to add a premium to business rates to pay for new infrastructure;
- alongside the business rate changes, Government's main grant to local authorities will be phased out;
- in the Autumn Statement/Spending Review 2015, the Treasury estimated 100% business rate retention will give local authorities control of £13 billion of additional local tax revenues and £26 billion in total business rate revenues;
- overall, the changes will have to be fiscally neutral, and to achieve this local authorities will be given £13 billion of additional responsibilities.

5. There is as yet no detail on additional responsibilities only that consideration could be given to transferring to local authorities responsibility for: financial support for older people with disabilities; the administration of housing benefit for pensioners; and funding public health. Transfer of funding for Transport for London's capital projects to local government is also being proposed.

CEDOS views:

6. There is as yet very little of the detail that is needed to be able to make a realistic assessment of the scheme and its likely impact, particularly as to how it will affect individual local areas and their councils. Indeed at the LGA's local government finance conference a Department for Communities and Local Government spokesman recognised that the Department has still look into how features of the system will work in the future[1].

7. Much of the detail remains to be developed and decided upon and for this we will have to await the consultation that the Government has promised by summer 2016. At this stage our views on the Government's proposals relate to the outlines that have been given so far and are covered in our response to the other main points on which the Committee is seeking evidence. As further details become apparent, CEDOS and its members welcome the opportunity to input and comment on these.

What responsibilities and functions should be devolved to local authorities to take account of the increase in their funding?

CEDOS views:

8. In order for the introduction of 100% retention of business rates and the accompanying phasing out of Revenue Support Grant to meet the Government's requirement of fiscal neutrality, there will be additional responsibilities and functions devolved to local authorities. So far there is no real detail, only suggestions that these could involve transferring responsibility for: financial support for older people with disabilities; the administration of housing benefit for pensioners; and for funding public health. Transfer of funding for Transport for London's capital projects to local government has also been referred to.

9. As a professional society for Heads of Economic Development, we are not in a position to comment on the devolution of responsibilities with regard to public health, housing benefit and financial support for older people. However, it will be important that the implications of these and other areas of devolved responsibility are considered carefully in the context of the demography of individual local areas as well as overall trends, including an ageing population and business conditions.

10. We consider that, whatever the final decisions on these issues are, the additional responsibilities must not be limited to the distribution of various forms of social benefit, however important, that are demand-led. Government and local government must focus on the fundamental purpose of allowing councils to retain 100% of business rate income, namely to enable local authorities to drive local economic growth. In our view, it is essential that key areas of additional responsibility must provide local authorities/areas throughout the country with the levers for driving business growth and prosperity in relation to, for example, skills development, business support, inward investment and infrastructure provision.

[1] *DCLG has done 'no thinking' on rates retention details* Municipal Journal 8 January 2016

11. In considering the overall issue of devolved responsibility it is important to recognise (a) that the figure of £13 billion of additional local tax revenues arising from the change to 100% business rate retention is based on forecasts; and (b) that the Government's commitment is to 100% retention to local government as a whole. The extent to which individual local authorities will see an increase will vary from area to area and will depend on their economic circumstances.

12. Whatever mix of functions is involved, it is evident there will be some significant transfers of responsibility to local government. In two-tier areas, the nature of the additional responsibilities involved could change the make-up of funding fundamentally and will need to reflect the distribution of responsibility between the tiers.

Other possible changes to the definition and collection of business rates

CEDOS views:

13. It is understood that the Government will report on its review of the business rate system early in 2016. It appears likely that a property based tax will continue to be the basis for the business rating system. As we said in our submission to the initial consultation for the Government's review of business rates issued by HM Treasury in May 2015, on balance the best way forward is to retain business rates as a property based tax but with provision for more local control and flexibility to enable more locally determined incentives for key business sectors[2]. In our submission, we acknowledged there is an issue of fairness in the treatment of internet-based companies in comparison with those requiring significant physical space but suggested that this could perhaps be better dealt with at national level and explored in the context of the corporation tax system rather than the business rate system, with consideration being given to an element of local distribution of a percentage of corporation tax income generated nationally.

14. For local authorities, the number of business rate appeals and the time they take to resolve is a major issue, which is restricting their ability to invest in economic development and support business. There is a clear need to reform the appeal system.

15. Since then the Government has issued a consultation on reforming business rate appeals[3]. This proposed a 'check, challenge, appeal' system, which is aimed at providing a quicker, clearer and more transparent service to businesses. It was suggested that the proposed reforms would lead to fewer speculative challenges and quicker decisions and provide greater financial certainty for local government. However, the timescales put forward for the check, challenge, appeal process indicate a three-year period for business rate appeals, which is not consistent with speeding up the process. Whilst the outcome of the consultation is awaited, we note that the District Councils' Network has called for the suggested period allowed for each stage in the new process be 'dramatically

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[2] *Submission to H M Treasury Business Rates Review* Chief Economic Development Officers Society (CEDOS) and the Association of Directors of Environment, Economy, Planning & Transport (ADEPT) May 2015
[3] *Check, challenge, appeal - Reforming business rates appeals* Department for Communities and Local Government October 2015

curtailed' and has put forward a timetable where the whole process would take no more than a year[4].

Effects of the retention of business rates in the context of the local authority financial settlement

CEDOS views:

16. In December 2016, Marcus Jones, Minister for Local Government was reported as saying that it is too early to assess the potential impact of the full localisation of business rate income on councils[5]. We agree that until the Government has issued details of how 100% business rate retention will operate in practice and what additional responsibilities will be placed on local authorities, a full assessment of the effects of the scheme cannot be made. However, we can put forward some broad points.

17. We reiterate that we support the full retention of business rates at local level. However, in implementing the change, Government must recognise the impact of the continuing cuts to local government funding. The Provisional Local Government Funding Settlement announced in December 2015 will result in further cuts to local councils' spending power on top of the very significant reduction in Government funding to local authorities of up to 40% during the last Parliament.

18. Inevitably the cuts are affecting local authority services. Although councils have tried to protect spending on social care services, other service areas including economic development have seen larger reductions. In our study on local growth in 2015 we highlighted the fact that the National Audit Office had reported a 47% reduction in budgeted spend 2010-11 to 2015-16 in the economic development service area, one of the highest reductions amongst individual service areas[6]. In our own 2015 survey of CEDOS members, around 70% reported economic development budget reductions, certainly for revenue, over the previous two years.

19. The introduction of 100% business rate retention, whilst welcomed, will be accompanied by the phasing out of the main Government grant to local authorities and £13 billion of additional responsibilities. Government must recognise that this will increase the financial risk to local authorities due to the increased dependence on business rate income, which is a relatively uncertain and volatile income stream. As the Local Government Association said in its analysis of the existing 50% business rate retention scheme, whilst it is intended to provide financial incentives to councils to grow their local economies, at the same time, it has resulted in more risk and uncertainty[7]. It identified the primary challenges as the level of financial risk that councils face due to appeals and dependence on a small number of large businesses for a significant proportion of business rate income.

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[4] District Councils Network response to "Check, challenge, appeal – reforming business rates appeals" January 2016

[5] *Rates retention scrutinised* Municipal Journal 17 December 2015

[6] *Local Authority Economic Development – Funding, Governance & Delivery* CEDOS May 2015

[7] *Business rate retention: the story continues* Local Government Association March 2015

20. This underlines the importance of ensuring that local authorities have the necessary levers and devolved powers to pursue effectively policies and actions to promote economic and business rate growth in their areas. It reinforces the point we have made above that the key areas of additional responsibility must focus on devolving powers and functions to local authorities/local areas that relate directly to driving business growth and prosperity. It also highlights a need to ensure that business rate devolution is accompanied by protection measures to enable local areas to cope with, for example, the impact of major business closures and the impacts of revaluation periods and appeals

21. At a broader level it supports the argument that local retention of business rates should be part of a wider approach to fiscal devolution to local areas. Other potential areas for devolved funding need to be examined both to reduce dependency on business rates as a single funding stream and to improve growth incentives for local authorities. In this context, there is a case for giving local authorities control over a wider range of tax revenues including local retention of stamp duty.

Differences in outcomes in richer and poorer areas and inter-authority competition

CEDOS views:

22. The introduction of 100% business rate retention and the associated phasing out of Revenue Support Grant plus new additional responsibilities will mean a considerable degree of local authority dependence on business rate income. This will inevitably increase competition between local authorities and it is also likely that it will result in a growing divergence between councils in terms of their spending power. Successful areas will benefit and other areas will lose out.

23. In terms of differences in outcomes, it is not just an issue of richer versus poorer areas. It will also depend on the risk factors associated with variations in local economic circumstances. For example, a relatively prosperous area could be at risk of negative outcomes due to dependence on individual industries, a small number of large companies and individual large business rate generators. There is also the possibility that it could favour councils in city and wider urban areas, which are likely to be able to offer greater attractions for incoming investors and expanding companies than more peripheral areas. Issues such as transport connectivity, availability of a skilled workforce, supply chain and access to high speed broadband remain significant differentiators between urban and more peripheral areas in terms of capacity for business growth. The differences in business rates to counter such factors could well be considerable, and such reductions may have unintended consequences, such as authorities not actually being able to invest sufficiently in the long term fundamental drivers of growth.

24. In two-tier council areas, the implications of 100% retention of business rates are less easy to determine and will depend on local geography and economic circumstances. With the lack of any spatial planning framework at county level, inevitably land use planning will be affected by the shift in policy on business rates and this could create starker contrasts between employment zones and residential areas. It is possible that the advantages of areas that have

better access to national transport networks and more significant brownfield land opportunities could result in investment being displaced from other areas and risk leaving them without a sustainable business rate base and in significant financial difficulty.

25. With the freedom to reduce business rates 'to win new jobs and generate wealth', there is a possibility not only of inter-area but also intra-area competition and a 'race to the bottom' in setting business rates. In some areas it could risk undermining consensus and business rate pooling mechanisms that have been agreed. This is an issue that needs to be examined carefully in developing the details of the 100% retention scheme.

Long-term future of redistribution to poorer areas and impacts on development

CEDOS views:

26. It will be important to protect the less well-off authorities but as yet there is no clarity on how any redistributive process will work. The effect of 100% business rate retention and the associated changes to local authority funding and responsibilities will be that an area's economic growth success will be a significant determinant of the funds available to the local authority to deliver services such as social care. It will be essential for a fundamental reassessment of need to be made prior to the start of the scheme to ensure baseline funding is at an appropriate level. It will be equally important for there to be provision to enable response to changing circumstances including economic shocks affecting individual areas.

27. Whatever approach to redistribution is taken, a balance must be struck to ensure that protection measures do not undermine the incentive to drive growth. As some of our members have said, there is a need to make sure there are no 'cliff edges' to receive support whereby an authority is better off by having no growth and therefore receives additional funding through the scheme, than if it had only a small amount of growth.

Role of directly elected mayors and LEPs

CEDOS views:

28. In the move to 100% business retention, it is essential for all areas, as far as possible, to have a level policy playing field on which to drive economic growth. In our view, the intention that only areas with elected city-wide mayors will be able to add a premium to business rates to pay for new infrastructure, is fundamentally at odds with this. We believe this power should be available to all areas with the provision that a majority of all businesses should agree, which we think is a reasonable one. In Combined Authority areas where there is an elected mayor, it will be essential to ensure there is support from the constituent authorities and for this an agreed spatial vision/framework for growth will be important. If the power is extended to all authorities, it emphasises further the importance of effective sub-regional working both within two-tier areas and between neighbouring authorities.

29. LEPs will have an important role in providing a business viewpoint and helping to achieve business involvement and support. However, local authorities will need to be satisfied that their LEPs can demonstrate their effectiveness in engaging with the wider business community in their areas.

Changes to the local role of businesses as a result of the proposals

CEDOS views:

30. Over and above the role of LEP's and wider business representative organisations, local authorities already have a duty to consult with local businesses as part of their budget setting processes. Likewise, local authorities have a long and proven track record of engaging with local businesses through their economic development and statutory services. This engagement and consultation will become increasingly important given the greater role locally derived business revenues will have in council finances.