The Chartered Institute of Public Finance & Accountancy

Response to the consultation document

Self-sufficient local government: 100% business rates retention

the people in public finance

CIPFA

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed.

As the world's only professional accountancy body to specialise in public services, CIPFA's portfolio of qualifications are the foundation for a career in public finance. They include the benchmark professional qualification for public sector accountants as well as a postgraduate diploma for people already working in leadership positions. They are taught by our in-house CIPFA Education and Training Centre as well as other places of learning around the world.

We also champion high performance in public services, translating our experience and insight into clear advice and practical services. They include information and guidance, courses and conferences, property and asset management solutions, consultancy and interim people for a range of public sector clients.

Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance. We work with donors, partner governments, accountancy bodies and the public sector around the world to advance public finance and support better public services.

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1. Introduction

CIPFA welcomes the opportunity to comment on this important matter concerning local government finance.

The consultation title belies the fact it concerns how vital local government services are to be funded across the country over the medium and long term. It is not solely about the important technical detail of managing 100% local retention of business rates. At CIPFA we continually looks to further good financial management in public finances. In the context of business rates retention we look to promote a transparent, fair and stable framework for local government finance across the whole of the country that is fit for purpose.

CIPFA's response is structured around our key strategic considerations and observations. For completeness our response also covers the separate but inextricably linked call for evidence from CLG on the review of needs and redistribution.

2. Overview

CIPFA's consistent view has been that 100% retention of business rates presents an important opportunity for local government but it comes with very significant short and medium term challenges that need to be managed carefully to ensure a fair and stable model.

Fundamentally, the demand for local government services, in local areas, does not correlate with the corresponding incidence and prospects of business rates income. As a result and at the heart of the challenge is the need to find an acceptable trade–off. This is between those areas with relatively buoyant business rate bases and good prospects for growth and those authorities where the opposite is true. The factors that create the difference are often more an accident of history and geography. This imbalance means that the scale, prospect and impact of possible growth will vary dramatically between individual authorities and between areas of the country. However, that does not diminish the importance of incentivising and rewarding growth.

That leads to a second key trade-off required in any national framework for the future. That is the trade-off between the incentive effects of allowing the proceeds of growth to be retained locally, versus redistributing that growth to cover risk elsewhere in the system to support less affluent areas. Both incentive and redistribution are equally valid considerations.

It is inevitable that the final design will have to find a balance between these conflicting and inherent tensions. Allowing constant redistribution undermines the local reward and incentives effect. But at the other extreme, allowing 100% retention of growth wherever that falls is guaranteed to create a two-tier access to vital local government services.

These challenges and inherent tensions seem well understood by the Department and the sector more widely but as in any solution requiring trade-offs, there is no right answer as to the correct balance. It will depend on the viewpoint of the key stakeholders involved. CIPFA commends the transparent and open process adopted by the shared CLG/LGA structures to formulate possible answers to these key questions; indeed we welcome the chance to add our voice to the deliberations through our membership of the Steering Group and supporting working groups.

3. Overall system framework

We are not aware of any formal regional dimension to the emerging framework but CIPFA does not rule out that it could form part of any final 100% business rates retention scheme design.

However, current regional boundaries still show a significant degree of economic difference between needs and resources within the current local government system. For that reason we would fully expect that any sub-national/regional solution would have to assume a degree of 'top up and tariffs' between regions if it was going to figure in the final overall national design in any significant and consistent way. (For the sake of a name, we refer to that as the 'Regions plus' approach but we do not explore that further in this response.)

In a world where 100% of business rates are being retained by local government, and in the current and medium term economic climate, it is almost inevitable that the final framework will need to handle and provide for the tensions of equalisation, incentivisation and risk, within the totality of the 100% of business rates being retained.

As already recognised by the Steering Group, the final design has to incorporate a realistic approach to the significant risk and volatility coming from appeals. It is also particularly important to ensure any emerging overall design solution is not just tested as to its likely efficiency on day one. It must be stress tested to show how it will deliver 'acceptable' results over the medium to long term. This must be done against a number of possible scenarios. Those scenarios should include the comparison of possible profiles of service demand over time against the corresponding possible profiles of business rates incomes; nationally, regionally and locally. CIPFA would also welcome a clear indication as to the Government's view on the degree of 'acceptable' divergence in spending power relative to need over time. That view could be particularly significant in the content of the Brexit result.

There is a question in the consultation about the process being built around combined authorities. We have to observe that in the main such authorities have come into existence as delivery vehicles for particular pooled growth related initiatives (excluding the health initiative in the Greater Manchester area.) While we recognise that growth initiatives are key elements of the local economy business rates are part of the totality of local government funding and must also support all other services.

In practical terms therefore it is difficult to see how the combined authority with a much more narrow focus could be in position to assume executive resource allocation decisions for the vast majority of service responsibilities outside its purview - Unless the constituent councils volunteered to such an arrangement.

4. Review of needs and redistribution: i.e., 'Fair Funding Review'

Although separately announced, the review of needs, and consequent redistribution implied at the start of the new 100% scheme is now a key component of the whole retention system design. For example, it will inevitably impact directly on notions of reset periods for needs and resources over time in the overall retention scheme.

We welcome the Government's commitment to a fundamental review but recognise that it inevitably will raise the major issue of resultant winners and losers. This cannot be avoided, and is not a reason to not undertake such a review.

Clearly, however, any resultant resource redistribution between councils, as a result of the 'Fair Funding Review', at the launch of the 100% retention scheme could greatly affect the scale of financial challenge on day one for the individual council concerned depending on how fair funding affects them. This emphasises the importance of not only consulting on possible statistical methods but also being prepared to work with the sector on options. The Government will need to exemplify, early and often in the process, on the possible local resource impacts of options under consideration. This is a key learning point from recent formula review experiences elsewhere in Whitehall.

The current regression based approach has its advantages and disadvantages. We do not discount that approach but CIPFA's view is that the Fair Funding Review is an opportunity to look more fundamentally at relative need within local government. In particular to seek to derive with the sector the 'value added' set of indicators of relative need. This can then be applied to each of the core demand/cost drivers facing local authorities. By 'value added' we do not mean a pre-determined target number of indicators but rather a range and number of indicators that each add value in explaining relative need.

This is, rather than treating the question of being one of whether the resultant formula is simple or complex to treating it as what is the most appropriate.

In such an approach it is difficult not to anticipate that; general population including age characteristics; aspects of geography and aspects of demography including certain deprivation indicators, will figure prominently. In our view the key will be transparency and early engagement with the sector on both the choice of statistical technique but also early and regular exemplifications of the impact to the technical groups. CIPFA would also strongly advocate that the process is informed by the use of independent technical statistical expertise that can provide robust challenge as the detailed work progresses. This last point also reflects learning from recent formula review work elsewhere in Whitehall.

As discussed, the Fair Funding Review will have opened up the perceived opportunity or risk, depending on how each council is affected, of significant resource redistribution on day one of the new 100% scheme. The Department should give early thought to the maximum nature of the total impact from day one of the introduction of this business rate scheme and the timeframe of the transition thereafter. Without a degree of early certainty on the maximum downside in 2020 onwards as a result purely of the needs review, many councils will feel the need understandably to reserve very prudently. In aggregate the risk of excess reserving due to this risk alone will be high. CIPFA would support actions that reduce this uncertainty.

The consultation on the fair funding element is relatively silent on the reality that 100% retention, compared to the current 50% scheme, means there will be a basket of 'new' services or responsibilities devolved to local government. Intellectually, therefore, it seems an imperative that the scope of a new relative needs formula includes these new relative demand drivers in some way.

In practice that may not be straight forward as not all of the possible new responsibilities to be devolved are currently attributed to each local authority area on a transparent formula basis. Clarity is required on this crucial point in any fair funding review and that is even more important if CLG propose to allow 'asymmetrical devolution', i.e., transfer certain specific responsibilities to certain councils, raising the additional challenge of applying relative needs in a transparent way to a different basket of services for some councils.

Finally in this area, CIPFA is of the view that any review of relative need must also take into account relative local resources and in particular an authority's council tax position. However, we would caution against any over-simplistic approach to incorporating relative differences in this capacity. We would instead propose the Department engage actively and openly with the sector as soon as possible on the methodology options, which would have broad support as appropriate and fair measures of this local capacity. This includes the fact there is a local incentive effect in promoting new homes, which needs to be taken into account in how this relative measure of capacity is formulated and applied in the overall Fair Funding Review outcome.

5. New responsibilities

Strategically, it is difficult not to recognise that some proportion of the available quantum, after moving from 50% to 100% retention, should be devoted to meet cost pressures in existing key local government services from 2020 onwards. Beyond that CIPFA would advocate that there is a balanced portfolio of new responsibilities as well as future demand for existing services.

In respect of new responsibilities, Government and the sector will wish to understand the cost and demand pressures from those new services over time compared to the range of possible business rate growth profiles.

In principle, CIPFA would support transferring new responsibilities where local government can directly influence improved economic growth and better social outcomes for their respective areas. Central government have a key part to play in this not least in recognising this dimension in their own formulation and in the granting of consequent freedoms for local government to maximise the positive influence they can exert to reshape these new responsibilities for best local outcomes.

However, from a risk and stability viewpoint, it is crucial for the Department and the sector to model the possible divergence risk over the medium term and ensure the new responsibilities do not represent a high risk portfolio of new demand led services compared to likely business rates growth.

As mentioned earlier, the debate on new responsibilities has thrown up a new concept, referred to as 'asymmetrical devolution'. This describes the situation where different responsibilities will be transferred to certain councils compared to the standard suite for the majority. Typically, this seems to be arising out of the current nominated 100% retention pilots in London, Liverpool and Manchester. On the one hand, devolution by definition will result in differences between areas. Maximising and harnessing local energy to deliver improved local outcomes is a positive outcome. On the other hand, however, the 100% retention scheme concerns a new national framework covering every council but based on a local tax with differing impacts and growth prospects locally and all not particularly correlated with need. In the absence of transparency as to what such arrangements may amount to in practice, CIPFA's would be concerned that asymmetrical devolution may lead to an inequality of opportunity between councils.

6. Risk

The most significant risk in any system of locally retained business rates is the impact of appeals. That risk is felt significantly already in the 50% scheme and without a new way of thinking will be magnified to such a point as to risk making the scheme unstable and unsustainable.

Under a new 100% scheme, CIPFA is absolutely clear that the impact of appeals arising from valuation errors must be handled in some pooled way. That is the clear view of the sector as a whole. That means some form of top slicing, and effectively the sector self-insures for the risk on a pooled basis. This top slicing will need to be taken into account as a first call on the available quantum overall but clearly it is in everyone's interests for the Valuation Agency to be properly resourced and incentivised to reduce the level of such errors on appeal.

We do not have a firm view on how such a pooled arrangement will operate but the emerging approach should be tested thoroughly and transparently. In operational terms, there will be complex technical matters as to how the pool is established, managed and paid out where necessary. On the related regulatory matters involved in such a new approach, CIPFA stand ready as normal to assist the Department and indeed that involvement has already commenced.

The other significant risk on the resources side is in relation to the negative effects of general economic conditions and/or local business decisions, which could see significant and sudden reduction in local business rates generally but also in particular areas. The current 50% scheme has a safety net. CIPFA is in no doubt that a safety net will still be needed under a 100% scheme. If there is not to be a direct levy as now, it will need to be some form of top slice. Again, a form of sector self-insurance. This will also raises a raft of technical matters has to how such a pool is managed and dispersed which need to be considered.

7. Reset

CIPFA's view is that for the system to be stable, there has to be periodic resets for both changes in relative need and changes in relative capacity. In relation to the latter, it seems only sensible, if some balance is to be kept between incentive and redistribution, for those to be partial resets, i.e. a transparent and not insignificant proportion of growth is retained.

For changes in relative needs, it seems sensible for that to be on some rolling basis perhaps subject to certain triggers. The choice of proportions and triggers will be a debate for the Sector and Government but stress testing likely scenarios will be vital before confirming a final design.

On partial resource resets, the joint technical groups are testing a reset cycle of five years. As the choice of time period is a trade-off between being too frequent and not frequent enough, five years seems reasonable. However, as mentioned earlier, public policy post Brexit may demand some avert expectation as to the maximum divergence in spending power that areas can expect over the medium to long term.

8. Implementation timeframe and process

The sector needs clarity as to whether the scheme will be implemented from April 2019 or 2020; not least as the former plays inconsistently into the apparent four year funding deals offered by Government which covers 2019/20 as the final year.

More fundamentally, CIPFA's concern is the risk that occurs when there is insufficient time to make sensible budgetary decisions. For the individual local authority, its budgetary cycle will require a significant lead in time and precise details of the day one financial position it would face at the launch of the scheme.

9. Conclusions

Local retention of 100% of business rates represent a medium to long term opportunity for the sector but with very significant short term challenges and inherent tensions that need to be successfully managed. Both incentive and equalisation are vital considerations and a trade-off between the two is necessary.

It is vital that exemplifications of possible impact are shared early and often with the sector as more detail design options emerge. CIPFA would also urge independent challenge and support as the process develops particularly in relation to the choice of statistical method underpinning the fair funding review elements. Both points reflect learning from recent formula review experiences elsewhere in Whitehall.

The pooling, via top slice, of appeals risk due to valuation error is vital but so is reducing such errors over time. Similarly, a stable system will require a safety net, which again will have to be funded from a top slice in the absence of a levy. More broadly, post Brexit; public policy may demand clarity on the ‘acceptable’ level of divergence in spending power across councils over time.