The Chartered Institute of Public Finance & Accountancy

CIPFA Response to CLG Consultation on Localisation of Business Rates

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CIPFA is pleased to respond on the proposals for business rate retention and commends the intention to move toward a more resilient local resource base. We recognise that the policy starts with the sound intentions of increasing localism and promoting growth and it is against these aims that we have reviewed the current proposals.

Localism brings a real tension between the ability to generate resources and underlying need. Full localisation of business rates with no equalisation mechanism would lead to increasing divergence between business rates growth and expenditure needs. It is recognised that whilst local authorities have a key role in generating growth this ability is also limited by geographical and locality issues. The link between business rates and economic growth will vary from area to area and may disadvantage rural areas and those reliant on growth in high-tech knowledge based economies that do not necessarily generate corresponding business rate growth. This link is further diluted by the decision to continue to set business rate levels nationally.

Fairness requires the need to incentivise local authorities to promote growth to be balanced with the need to protect services in vulnerable areas. Achieving this balance becomes even more difficult in the current economic environment when local authorities are facing a period of sustained cuts. The equalisation mechanism may need to operate differently in times of cuts to times of income growth, for example a higher degree of protection may be needed in times of cuts. In order to generate growth nationally and not leave the most deprived areas with no ability to regenerate, the safety mechanism needs not only to recognise basic need but also the need for investment.

The pre-assumption of growth in the calculation of the baseline and the inclusion of the top-slice, adds to the considerable risk transfer from central to local government. The proposals risk becoming increasingly complicated with a high degree of volatility and risk around predictability both within and between years. The risks around predictability and volatility are compounded by the impact on council tax. The previous system equalised not only for business rates but also council tax. Council tax has not been taken fully into account in the new system. These risks do not fall evenly across local authorities particularly when council tax is taken into account, so the proposals leave widely divergent gearing ratios. In the final version of the system the Government therefore needs to ensure that it considers the impact not only at the macro level of the national position but also at the micro level where the impact on individual local authorities can be more significant compared to their size and functions.

There is a danger that the risks associated with the new system, especially when viewed alongside other proposed changes such as council tax benefit localisation will lead to more cautious decisions by local authorities about reserve levels at a time when investment in local economies has never been more important. Given the above concerns we would urge the government to consider whether the present timescale is realistic or whether a more extended timetable for implementation could be considered.

We have provided specific comments under each heading and would be happy to discuss our comments further and provide further input into the design of the final solution.

Component 1: Setting the Baseline

The proposals provide only for equalisation in year 1 and take the current distribution as the starting point. It should be recognised that the current system does not necessarily reflect need, particularly as a result of the application of floors, although it is recognised that stability is important in the current climate.

In setting the baseline it is therefore vital that the process is transparent and can be explained to council tax and business rate payers. Considerable work will be needed to explain how the new system works and the government will wish to consider what should be done on a national basis to support local consultation.

Component 2: Setting the Tariffs and Top Ups

The tariffs and top ups need to be set up so that both growth areas and those areas with low or negative growth can benefit from national growth.

In view of the wide range of impacts on individual authorities a more cautious approach may be necessary in the early days to ensure the long term viability of the system and avoid the potentially serious impact of divergent growth rates.

The current proposals lead to widely differing gearing ratios for individual local authorities, particularly when council tax is taken into account, which may lead to unacceptable levels of local risk. A stronger safety mechanism may be required in the early years to acknowledge the transfer of new risk and the current national economic picture.

Component 3: The Incentive Effect

The approach assumes a link between economic growth and business rate growth. This does not reflect the emergence of new technologies that mean economic growth may occur without a corresponding increase in the business rate base. It may be possible to mitigate this impact by allowing local setting of business rate levels that could reflect investment in technological infrastructure such as superfast broadband or development of highly skilled workforces.

Component 4: A Levy Recouping a Share of Disproportionate Benefit

We support the proposal for a levy on disproportionate benefit provided that levy remains within the local government finance system and is not retained by central government or used to fund additional burdens.

In a time of low growth the levy should be used to protect low growth areas and help them avoid further economic decline. The levy will provide an important safety net to help maintain long-term sustainability across all regions. In deciding at what level the protection provided by the levy kicks in, it is however important to consider the impact on individual local authorities of reducing real resources. The formulation of the levy may need to be reconsidered should economic growth improve.

Component 5: Adjusting for Revaluation

It needs to be recognised that adjusting for revaluation is not a neutral option. It will have a differential impact on the gearing of individual local authorities and not just their absolute resource levels. The impact of revaluation appeals and the time lags between revaluation and appeals being settled may also cause problems for a simple adjustment. The impact of successful appeals will be another factor that needs to be taken into account.

Component 6: Resetting the System

It is vital that there is the ability to reset the system to avoid a significant divergence between need and resources over time, as well as to ensure that tariff levels remain appropriate. We recognise the impact of resets on distribution and the difficulties that this can create, so suggest that a time limit should be put on the time between resets. We suggest that the time between resets should be no more than five years and may need to be more frequent in the early years. A five year period should balance flexibility with the need to allow for the payback of investment, with larger schemes being covered by TIF and EAZs.

Component 7: Pooling

There is a danger that pooling adds further unpredictability and lack of transparency to an already complex system. Pooling is not a neutral decision and will have an impact on the national system and distribution of resources. We therefore believe that incentives for pooling should not be offered allowing the decision to pool to be made entirely on its merits within local areas.

Chapter 4: Interactions with Existing policies and Commitments

The system as currently set out does not adequately cover the interaction of localised business rates with council tax. Under the current proposals all council tax growth will remain with individual local authorities as levies tariffs and top-ups appear to be applied to business rates only. The interaction of the proposed system for business rates will therefore bring further divergence between the gearing ratios for individual authorities. This appears to give a more long term impact on resources than envisaged by the New Homes Bonus.

Chapter 5: Supporting Local Economic Growth Through New Instruments

There is a direct interaction between the investment decisions local authorities make under the Prudential Code and resource predictability. Local authorities will be more inclined to invest when they have security over future resources. There will be a trade off between the length of time between resets and predictability of resources for investment. We, therefore, support the proposal to safeguard EAZs and major TIF schemes from the impact of the reset and levy. The overall number of projects will however need to be managed to avoid a disproportionate impact on the national system. Securitisation of revenues is only likely to be relevant for the larger schemes which would be covered by the safeguards from the impact of the reset and levy.