



## Japan Local Government Centre, London

### Monthly Report for August 2011 – Local Government Resource Review

*(please see March 2011 Monthly Report 'Local Government Resource Review' for overall background to the review)*

#### **Background**

Currently local councils in England receive their funding from three main sources: grants from central government; council tax; and other locally generated income (such as fees and charges for services). Britain's local government finance system is one of the most centralised in the world and its councils get more than half of their income from central government grants.

Central government grants can be received as 'specific grants', which can come with restrictions on what they can be spent on, or through 'formula grant', which has no restrictions and can be used by the authority for any purpose. The formula grant funds a wide range of local services, including children's services, adult social services, police, fire, and highways maintenance, and is distributed to all local authorities using a complex formula.

One of the main components of formula grant is National Non-Domestic Rates, commonly known as 'business rates'. Business rates are collected by local authorities from businesses in their areas like shops, offices, warehouses and factories, but they are currently paid into a central pool to be redistributed as part of formula grant. This system means that local authorities do not have any financial incentive to promote business growth in their area, as they will not receive any of the business rates receipts from any new development.

The UK Government wants to change the current system by enabling councils to keep a share of the growth in business rates in their area. This will make councils more financially independent from central government and give them a strong incentive to promote local business growth. It is not proposing to make any changes to the way businesses pay tax or the way the tax is set. Rate setting powers will remain under the control of central government.

Councils can already raise additional revenues from the rating system through a Business Rate Supplement in order to fund a specific project which promotes economic development, or they can encourage Business Improvement Districts to form – where businesses themselves agree to pay an additional amount to fund improvements in the area. In both these examples there are protections for businesses. There must be a referendum of local businesses before a Business Improvement District forms and the Localism Bill is changing the law so that the

same applies for any Business Rate Supplement proposal, rather than a ballot of businesses happening only when certain criteria are met. The Localism Bill is also amending the law to allow councils to introduce local business rates discounts, funded by the council.

### ***Local Government Resource Review: Proposals for Business Rates Retention***

In July 2011 the Department for Communities and Local Government published for consultation the findings of the first phase of its joint review with HM Treasury around the relocalisation of business rates in England.

The main thrust of the proposals under its findings are to return to local government in England the ability to retain revenues from rates levied on local businesses in each council area, while attempting to ensure both simplicity and fairness towards any councils who might potentially lose out under any end to equalisation and redistribution centrally.

Put simply, if all councils are to keep all of the business rates generated in their areas, some areas would have a much larger amount than they need to deliver their services, while some others would have much less than they need. So, to ensure a fair starting position for the new system, the government is proposing to take an amount of business rates away from those with too large an amount in comparison to their current spending (the so-called “tariff” in the government’s consultation document) and top up those authorities with too little, again in comparison to their current spending (this is referred to as the “top up” in the consultation document).

In future years therefore, the amount of business rates that central government gives or takes from each local authority will remain fixed. This means that any growth in business rates an authority achieves will be kept by them. This is believed to create a strong incentive effect to promote growth. There would be no fixed limit on the amount of business rates growth an authority can benefit from under the new system. The more any authority grows its business rates base, the better off it will become.

However, some local authorities with large amounts of business property in their area may stand to gain disproportionate amounts. Where this happens, they are proposing to take back a share of their growth (this is referred to as the “levy” in the consultation document).

The Government proposes to use the proceeds of this to give financial help to those authorities who experience significant drops in business rates, for example caused by the closure or relocation of a major business. It also proposes to protect those authorities who are less able to grow. Depending on the amounts raised, the proceeds could also be redistributed to authorities with lower growth, or fund schemes, for example, for regeneration, in areas with high growth potential.

In the future, the Government may judge that the level of a number of councils’ business rates no longer meet changing pressures on local services. In this situation,

it could choose to 'reset' the fixed amounts of business rates that were either taken from councils with too high levels of business rates or given to those with too low levels. This would probably involve a new assessment of local authorities' need.

The Department will now consult on its proposals until late October 2011, after which legislation will be introduced in the form of a Local Government Finance Bill. The consultation also includes an earlier commitment to legislate to introduce Tax Increment Financing. This would enable councils to pay for future infrastructure developments by allowing them to borrow against projected rate growth. Councils are not currently permitted to retain their rates so cannot borrow against them. Rate retention would remove this barrier.

*Any opinions expressed in this report, which is prepared for translation, are solely those of the author and do not necessarily represent those of JLGC or CLAIR.*