LOCAL AUTHORITY BUSINESS GROWTH INCENTIVES - CONSULTATION

1 SUMMARY

1.1 This report seeks Members' views in respect of the above consultation paper issued by the Office of the Deputy Prime Minister (ODPM) and H.M. Treasury on 4 July. Responses are required by 31 October 2003.

2 BACKGROUND

2.1 Prior to April 1991 business rates were levied by individual councils and the proceeds were kept by those authorities. In a two-tier system, such as Essex, the County and District Councils would levy a business rate. The Districts collected the taxes and passed the County element on to the County Council.

2.2 With the introduction of the community charge, business rates were set by the Government. District Councils continued to collect the charge, but all proceeds are passed to central Government. These proceeds are pooled and redistributed to individual authorities in the form of general grant on a per head of population basis.

2.3 Under the former system, there were direct financial incentives to attract businesses into the area. Once business rates were pooled, the incentive was removed.

2.4 The Government now wishes to re-introduce an incentive to authorities to attract businesses into their area by allowing them to retain a proportion of the business rate.

3 CONSULTATION PAPER

3.1 The full consultation paper is on deposit in the Members Library at the Rayleigh Council offices.

3.2 <u>Share Objectives</u>

3.2.1 The objectives of the scheme are:

- To give all authorities an incentive to maximise economic growth
- To give successful authorities additional revenues that are not ringfenced in any way.

3.2.2. The scheme must align with the dual objectives of the regional Public Service Agreement growth targets. This means ensuring the scheme does not create stronger incentives in high growth areas than in low growth areas. Authorities should benefit because of their relative future performance rather than their relative circumstances.

3.2.3. The scheme should be fair. Authorities should not receive benefits from the scheme that are out of proportion to their size.

3.2.4. The scheme should be as intelligible and transparent as possible.

Q1. Do you agree with the principles for the scheme?

Officer Comment – The proposal to restore some financial incentives to those authorities that attract more business into the District is commended.

Whenever new business premises set up in an area, there is always additional cost with respect to infrastructure, services, etc. Retaining an element of the business rate increase would go some way to offsetting these costs.

It is interesting to note that Government will seek to cap the reward based upon the size of the authority. This may not reflect the need of an authority to increase expenditure if a large development were to take place in a small shire district.

3.3. The Policy Rationale

3.3.1. This element of the consultation explains how the proposed scheme fits in with Government policies. No questions are asked in this section of the document.

3.4. Baselines

3.4.1. Baselines will be determined for each authority. In essence, the baseline represents the growth in valuation of properties. If an authoritiy's growth in valuation does not match the baseline (as amended by the floor, see para. 3.5.1. below), they will not be awarded any additional revenues. If, however, growth exceeds the baseline, then the authority will be allowed to keep a proportion of the additional income above the baseline. Baselines will be constructed using data for the years 1995 to 2003.

3.4.2. The Government has proposed a number of models by which to establish the baseline. These are:-

- National model: All local authorities grouped together with a single national baseline
- Regional model: Local authorities grouped according to the nine English Government Office regions

- National historic growth model: Local authorities grouped into five groups of roughly even numbers according to historic growth, ie., those with historic growth in the bottom 20% appear in the bottom group, second 20% are in the second group, etc.

- Sub regional model: A combination of the regional and national historic growth models with local authorities first placed into regions and then sub-divided into three groups of roughly even numbers according to historic growth.

- Local authority model: Each local authority is treated individually and against its own historic growth.

3.4.3. The models have been evaluated to determine the incentive effects, distributional effects and intelligibility.

3.4.4. With regard to incentives, the models are assessed to show how well they show average growth and how well they predict future growth.

3.4.5. With regard to actual growth, the local authority model is the most accurate, with the national historic growth and sub-regional next. When comparing predictability, the national model was the most accurate, followed by the regional and then sub-regional.

3.4.6. When distributional effects were considered, national historic growth and sub-regional models were the best performers. The regional model does not perform well and the Government recommends that this model is discounted.

3.4.7. The intelligibility test looks at how simple the scheme is to operate and how intelligible it is to the outside world. The Government view on intelligibility is set out below:-

- National model is simple as it has only one baseline. Probably most understandable, but local residents would question why their local authority should meet a national target.

- Regional model fairly simple as only has nine baselines. Whilst regional economy concepts are more widely understood and accepted, there are nevertheless considerable variations at local level.

- National historic growth is simple in that it only has five baselines. Not very understandable as it uses new categorisations. Difficult to explain why an authority in the South West could be grouped with an authority in the North East, but not with a neighbouring authority.

- Sub-regional – this is more complex as it has 27 groupings. More understandable as it produces fewer options in any one region and does not create the odd situation where authorities can be grouped together when they are several hundred miles apart.

- Local authority – this is more complex as it involves creating a baseline for each individual authority. It would, however, be more understandable. The main weakness is that it uses historical data to predict future performance. It is likely to be more volatile than a larger grouping.

Q2 Do you agree with using an eight-year period for setting the trend?

Officer comment – Eight years would seem reasonable. The period selected would ensure that all relevant data is available for the scheme to go live in April 2005.

Q3 Are there models for setting the baseline that the Government has not considered that need to be considered?

Officer comment – As a small authority, we do not have the resources to investigate this issue and therefore are unable to comment.

Q4 Which of the baseline models is your preferred option and why?

Officer comment – From information shown on the ODPM website, the baseline for Rochford on the five models is as follows:-

National	*2.5%*
Regional	*2.4%*
National Historic Growth	*1.6%*
Sub-regional	*1.6%*
Local	*1.4%*
Average growth:	
1995/6-1999/00	*1.4%*
2000/01-2002/03	*1.4%*

The Government has indicated that it does not favour the national, regional and local models, owing to the analysis under incentive and distributional effects.

Fortunately, Rochford's growth is reasonably close to both the national historic grown and sub-regional models.

It would, therefore, probably be best to pick the sub-regional model, as it would at least give a baseline similar to other authorities in the region.

3.5. The next section of the consultation deals with floors, scaling factors, ceilings and tiers.

3.5.1. The Government will set a floor, which could be set at any level above or below the baseline. For example, the floor could be set at -1% below the baseline. In Rochford's case, our baseline would be 1.6%. With the floor set at –1%, the Council would only need to achieve growth in excess of 0.6% to qualify for retaining an element of the business rate. Conversely, if the floor were set at 1% above base, we would need to achieve growth of 2.6% before receiving any benefit.

3.5.2. Scaling factors would be applied to the amount of growth achieved above the floor. For example, if the scaling factor were set at 50%, then any rate increase generated above the floor would be split, 50% continuing to go into the national pool and 50% being retained by the local authority.

3.5.3. Ceilings will be set in order to ensure that no authority receives a large sum purely because an exceptionally large development has taken place in their area. It is proposed that the ceiling is set at 1% of Financial Spending Share (FSS) in year 1, 2% in year 2 and 3% in year 3 and subsequent years. Rochford's FSS is currently £9.7m. This means any benefit would be capped at £97,000 in year 1, £194,000 in year 2 and £291,000 thereafter.

3.5.4. The Government is proposing that the scaling factor should be set within a range of 60% to 95%.

3.5.5. The options with regard to setting the scaling factor will depend upon the level at which the floor is set. The variants have been identified:

- High floor/high scaling factor – under this option a high floor would be set so that approximately only 54% of authorities will receive benefit without improving performance. This will be compensated for by giving a high scaling factor of, say, 95% of revenue being retained at local level. It is estimated that, under this proposal, 25% of authorities could reach their ceiling in year 1, falling to less than 20% in year 3.

- Medium floor. Medium scaling factor – under this option the floor would be set in order that around 75% of authorities would benefit, but the scaling factor would be set at around 65% being retained by authorities. Under this option around 30% of authorities would reach the ceiling in year 1, falling to over 20% in year 3.

3.5.6. The Government is not attracted to a low floor, as it believes it would give little incentive to improve.

3.5.7. In setting high floor/high scaling, the local authorities would probably need to spend more to encourage more business into their area and hence they would receive a greater reward.

3.5.8 The medium floor/medium scaling scenario would work on the basis that authorities would need to achieve more by utilising existing budgets.

3.5.8. Consideration also needs to be given to sharing the benefit between the County and District Councils. The Government has stated that sharing will not take place with police and fire authorities.

3.5.9. The two extremes would be a share pro-rata to FSS which would result in 85% Counties and 15% Districts. The other would be economic development spend over the baseline period which would equate to 15% to Counties and 85% to Districts.

3.5.10. The Government is considering a 50:50 split, but will be carrying out further investigations before coming to a final judgement.

Q5 Which of the two preferred options for floors and scaling factors (high/high and medium/medium) do you think provides the best balance between financial support and financial incentive?

Officer comment – Adopting the high/high scenario may well prohibit smaller authorities from benefiting owing to restricted budgets. Bringing in new business is crucial to the local economy of all areas. By adopting the medium/medium option all authorities will be encouraged to improve, giving greater benefit nationwide.

Q6 Do you agree with using formula spending shares as a measure for determining ceilings? Do you agree that a 1% ceiling in year one of the scheme, rising in line with the scheme (ie., reaching 3% in year three), provides an adequate balance of incentive and cap on gains?

Officer comment – answering this question infers that the Council supports the concept of imposing caps. Members need to determine a view on this in the first instance. If caps are agreed, the proposals set out would be easily understood and workable.

Q7 How do you think that benefits should be shared between different tiers of local government?

Officer comment – Counties should receive an element of the rates as they would probably need to have a major involvement in encouraging business into the area. The actual impact, however, is very much at local level and local residents need to see actual benefits accruing to the locality. This would support an argument for a greater percentage going to Districts than to Counties. Members may wish to withhold on suggesting an actual figure until such time as the Government makes a firm proposal.

3.6. The remainder of the consultation paper concentrates on the next steps for implementing the scheme on 1 April 2005. It invites local authorities to participate in carrying out a “dry run”.

Q8 Would you like to volunteer to be part of the administrative dry run?

Officer comment – following the Finance Best Value Review, Members authorised officers to seek partners to carry out the national non-domestic rate function. It would not, therefore, be appropriate to volunteer for this task at this time.

4 RESOURCE IMPLICATIONS

4.1. The authority may receive additional finance from this scheme in 2005/6, but this will depend on the levels of floors and scaling factors set by the Government.

5 RECOMMENDATION

5.1 It is proposed that the Committee **RESOLVES**

(1) To respond to the consultation on the basis of the above report, subject to additional Member amendments and comments.

(2) To copy the Council's agreed response to the Local Government Association, Sir Teddy Taylor, MP and Mr. Mark Francois, MP. (CD(F&ES))

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Background Papers:

None.

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