Institute for Fiscal Studies

The Autumn Statement, Business Rates, and Local Government

5th December 2016

Local Government Association

The Local Government Finance and Devolution Consortium is generously supported by the following organisations, as well as a large group of local government bodies:

CAPITA CIPFA E·S·R·C ECONOMIC & SOCIAL RESEARCH COUNCIL pwc THE MJ

Changes to the underlying borrowing forecast

£ billion	2016–17	2017–18	2018–19	2019–20	2020–21
Budget March 2016	**55.5**	**38.8**	**21.4**	**-10.4**	**–11.0**

Changes to the underlying borrowing forecast

Institute for Fiscal Studies

£ billion	2016–17	2017–18	2018–19	2019–20	2020–21
Budget March 2016	**55.5**	**38.8**	**21.4**	**-10.4**	**–11.0**
Classification changes:	*+0.5*	*+0.4*	*+0.5*	*+6.4*	*+4.1*
New March Baseline	***56.0***	***39.2***	***21.9***	***–4.1***	**–6.9**

Changes to the underlying borrowing forecast

£ billion	2016–17	2017–18	2018–19	2019–20	2020–21
Budget March 2016	**55.5**	**38.8**	**21.4**	**-10.4**	**–11.0**
Classification changes:	*+0.5*	*+0.4*	*+0.5*	*+6.4*	*+4.1*
New March Baseline	***56.0***	***39.2***	***21.9***	***–4.1***	**–6.9**
Weakness in 2016-17 and modeling changes	*+8.2*	*+9.6*	*+9.6*	*+9.5*	*+11.6*

Changes to the underlying borrowing forecast

£ billion	2016–17	2017–18	2018–19	2019–20	2020–21
Budget March 2016	**55.5**	**38.8**	**21.4**	**-10.4**	**–11.0**
Classification changes:	*+0.5*	*+0.4*	*+0.5*	*+6.4*	*+4.1*
New March Baseline	***56.0***	***39.2***	***21.9***	***–4.1***	**–6.9**
Weakness in 2016-17 and modeling changes	*+8.2*	*+9.6*	*+9.6*	*+9.5*	*+11.6*
Changes to future economic forecast	*+3.2*	*+8.3*	*+10.6*	*+8.5*	*+6.5*

Changes to the underlying borrowing forecast

£ billion	2016–17	2017–18	2018–19	2019–20	2020–21
Budget March 2016	**55.5**	**38.8**	**21.4**	**-10.4**	**–11.0**
Classification changes:	*+0.5*	*+0.4*	*+0.5*	*+6.4*	*+4.1*
New March Baseline	***56.0***	***39.2***	***21.9***	***–4.1***	**–6.9**
Weakness in 2016-17 and modeling changes	*+8.2*	*+9.6*	*+9.6*	*+9.5*	*+11.6*
Changes to future economic forecast	*+3.2*	*+8.3*	*+10.6*	*+8.5*	*+6.5*
AS November 2016 (pre-measures)	**67.2**	**56.4**	**42.0**	**13.6**	**11.2**

Changes to the underlying borrowing forecast

£ billion	2016–17	2017–18	2018–19	2019–20	2020–21
Budget March 2016	**55.5**	**38.8**	**21.4**	**-10.4**	**–11.0**
Classification changes:	*+0.5*	*+0.4*	*+0.5*	*+6.4*	*+4.1*
New March Baseline	***56.0***	***39.2***	***21.9***	***–4.1***	**–6.9**
Weakness in 2016-17 and modeling changes	*+8.2*	*+9.6*	*+9.6*	*+9.5*	*+11.6*
Changes to future economic forecast	*+3.2*	*+8.3*	*+10.6*	*+8.5*	*+6.5*
AS November 2016 (pre-measures)	**67.2**	**56.4**	**42.0**	**13.6**	**11.2**

OBR's estimate of Brexit effect on borrowing: +£15.2 billion in 2019-20

Changes to the underlying borrowing forecast

£ billion	2016–17	2017–18	2018–19	2019–20	2020–21
Budget March 2016	**55.5**	**38.8**	**21.4**	**-10.4**	**–11.0**
Classification changes:	*+0.5*	*+0.4*	*+0.5*	*+6.4*	*+4.1*
New March Baseline	***56.0***	***39.2***	***21.9***	***–4.1***	**–6.9**
Weakness in 2016-17 and modeling changes	*+8.2*	*+9.6*	*+9.6*	*+9.5*	*+11.6*
Changes to future economic forecast	*+3.2*	*+8.3*	*+10.6*	*+8.5*	*+6.5*
AS November 2016 (pre-measures)	**67.2**	**56.4**	**42.0**	**13.6**	**11.2**

OBR's estimate of Brexit effect on borrowing: +£15.2 billion in 2019-20 (£290 million per week)

Autumn Statement policy changes

Institute for Fiscal Studies

£ billion	2016–17	2017–18	2018–19	2019–20	2020–21	2021–22
AS pre-Measures	**67.2**	**56.4**	**42.0**	**13.6**	**11.2**	**11.6**
AS November 2016	**68.2**	**59.0**	**46.5**	**21.9**	**20.7**	**17.2**

Autumn Statement policy changes

£ billion	2016–17	2017–18	2018–19	2019–20	2020–21	2021–22
AS pre-Measures	**67.2**	**56.4**	**42.0**	**13.6**	**11.2**	**11.6**
Tax changes:	*0.0*	*-0.6*	*-0.6*	*-1.1*	*-0.8*	*-0.5*
Giveaways	*0.0*	*+1.5*	*+1.7*	*+1.3*	*+1.4*	*+1.6*
Takeaways	*0.0*	*-2.2*	-2.3	-2.4	*-2.2*	*-2.0*
AS November 2016	**68.2**	**59.0**	**46.5**	**21.9**	**20.7**	**17.2**

Autumn Statement policy changes

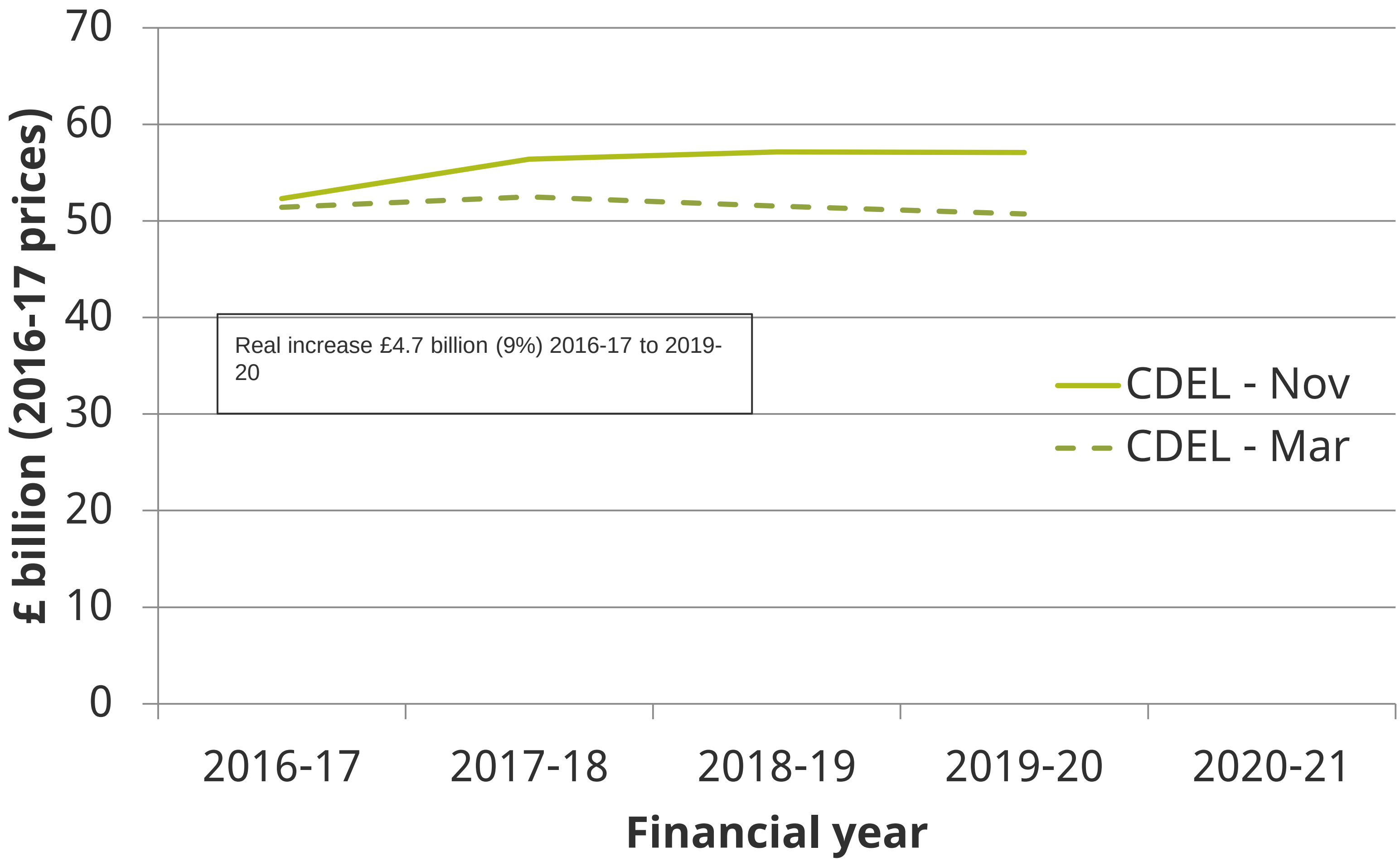
£ billion	2016–17	2017–18	2018–19	2019–20	2020–21	2021–22
AS pre-Measures	**67.2**	**56.4**	**42.0**	**13.6**	**11.2**	**11.6**
Tax changes:		*-0.6*	*-0.6*	*-1.1*	*-0.8*	*-0.5*
Giveaways	*0.0*	*+1.5*	*+1.7*	*+1.3*	*+1.4*	*+1.6*
Takeaways	*0.0*	*-2.2*	-2.3	-2.4	*-2.2*	*-2.0*
Spending changes:	*+0.9*	*+3.0*	*+5.0*	*+9.2*	*+9.7*	*+4.0*
Welfare	*+0.2*	*+1.0*	*+2.2*	*+1.8*	*+1.9*	*+2.4*
Other spending	*+0.8*	*+2.0*	*+2.7*	*+7.4*	*+7.8*	*+1.6*
AS November 2016	**68.2**	**59.0**	**46.5**	**21.9**	**20.7**	**17.2**

Autumn Statement policy changes

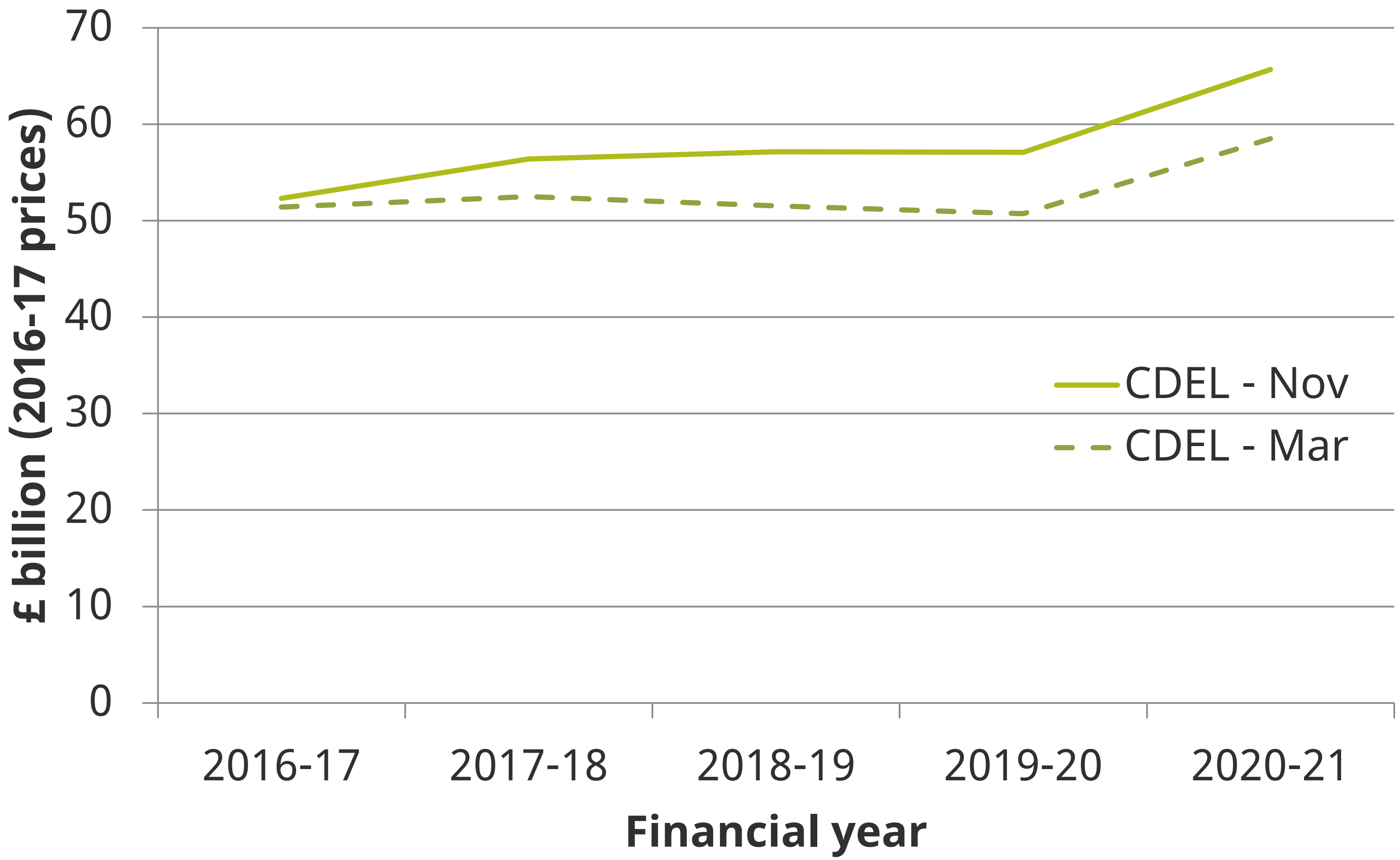
£ billion	2016–17	2017–18	2018–19	2019–20	2020–21	2021–22
AS pre-Measures	**67.2**	**56.4**	**42.0**	**13.6**	**11.2**	**11.6**
Tax changes:		*-0.6*	*-0.6*	*-1.1*	*-0.8*	*-0.5*
Giveaways	*0.0*	*+1.5*	*+1.7*	*+1.3*	*+1.4*	*+1.6*
Takeaways	*0.0*	*-2.2*	*-2.3*	*-2.4*	*-2.2*	*-2.0*
Spending changes:	*+0.9*	*+3.0*	*+5.0*	*+9.2*	*+9.7*	*+4.0*
Welfare	*+0.2*	*+1.0*	*+2.2*	*+1.8*	*+1.9*	*+2.4*
Other spending	*+0.8*	*+2.0*	*+2.7*	*+7.4*	*+7.8*	*+1.6*
AS November 2016	**68.2**	**59.0**	**46.5**	**21.9**	**20.7**	**17.2**

Capital departmental spending – 2016-17 to 2019-20

Institute for Fiscal Studies



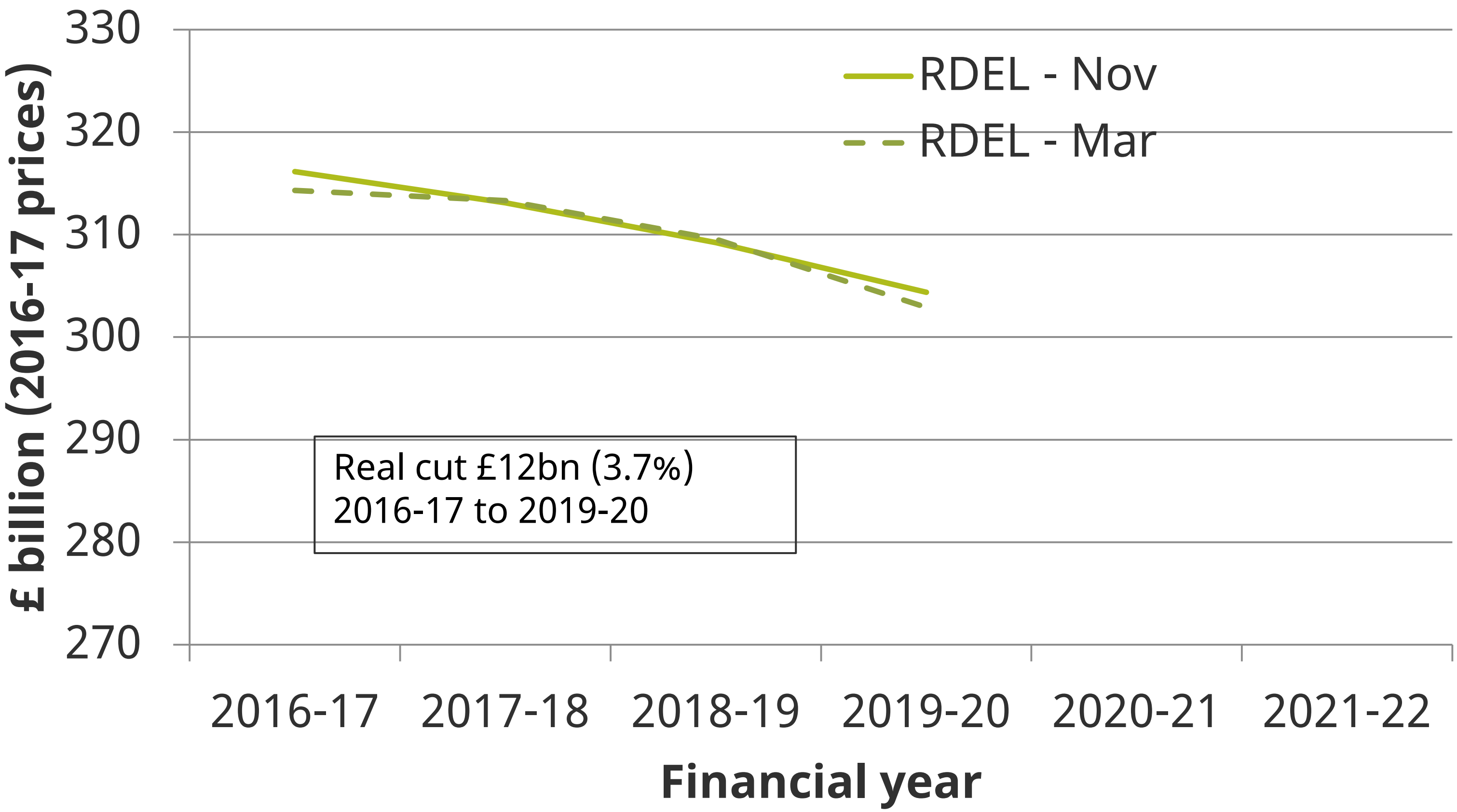
Capital departmental spending – 2016-17 to 2020-21



Capital spending and councils

- National Productivity Investment Fund of £17 billion over next 4 years
  - Housing, Transport, Telecoms and R&D
- New ‘Housing Infrastructure Fund’: £60 million next year, growing to £1.4 billion in 2020-21
  - To help fund infrastructure for new private sector houses
  - Competitive bids for funding by councils
  - Existing funding for transport may be retargeted at housing growth
- Combined authorities to gain capital borrowing powers
- Government to consult on allowing councils to borrow £1 billion at Gilts + 60 basis points for “high value infrastructure projects”

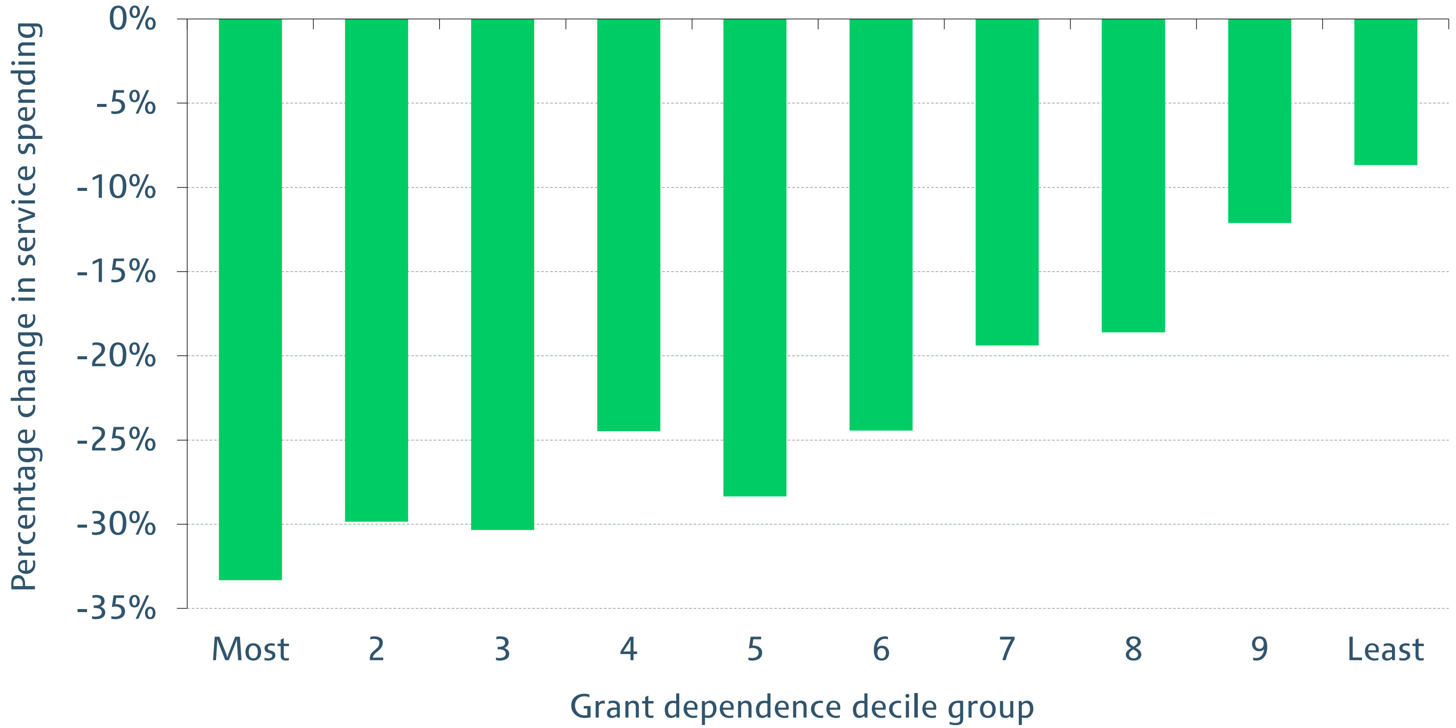
Current departmental spending – 2016-17 to 2019-20



Resource spending pressures to 2019-20

- No extra money for the NHS or councils' social care
  - Analysis by health charities suggest £2.3 billion social care funding gap even if social care precept fully used
  - Not all councils raising council tax by full 4% possible
- £1 billion of cuts in 2019-20 will be recycled into "priority areas"
- A range of policies will impact on councils' spending power
  - Apprenticeship Levy
  - National Living Wage (now likely lower than previously expected)
  - Increase in IPT and cut in petrol duty

Cuts to service spending, 2009-10 to 2016-17, by councils' grant-dependence in England



Knowsley– 35% cut

Camden – 39% cut

Oldham – 42% cut

Luton – 19% cut

Milton Keynes – 27% cut

Norfolk – 15% cut

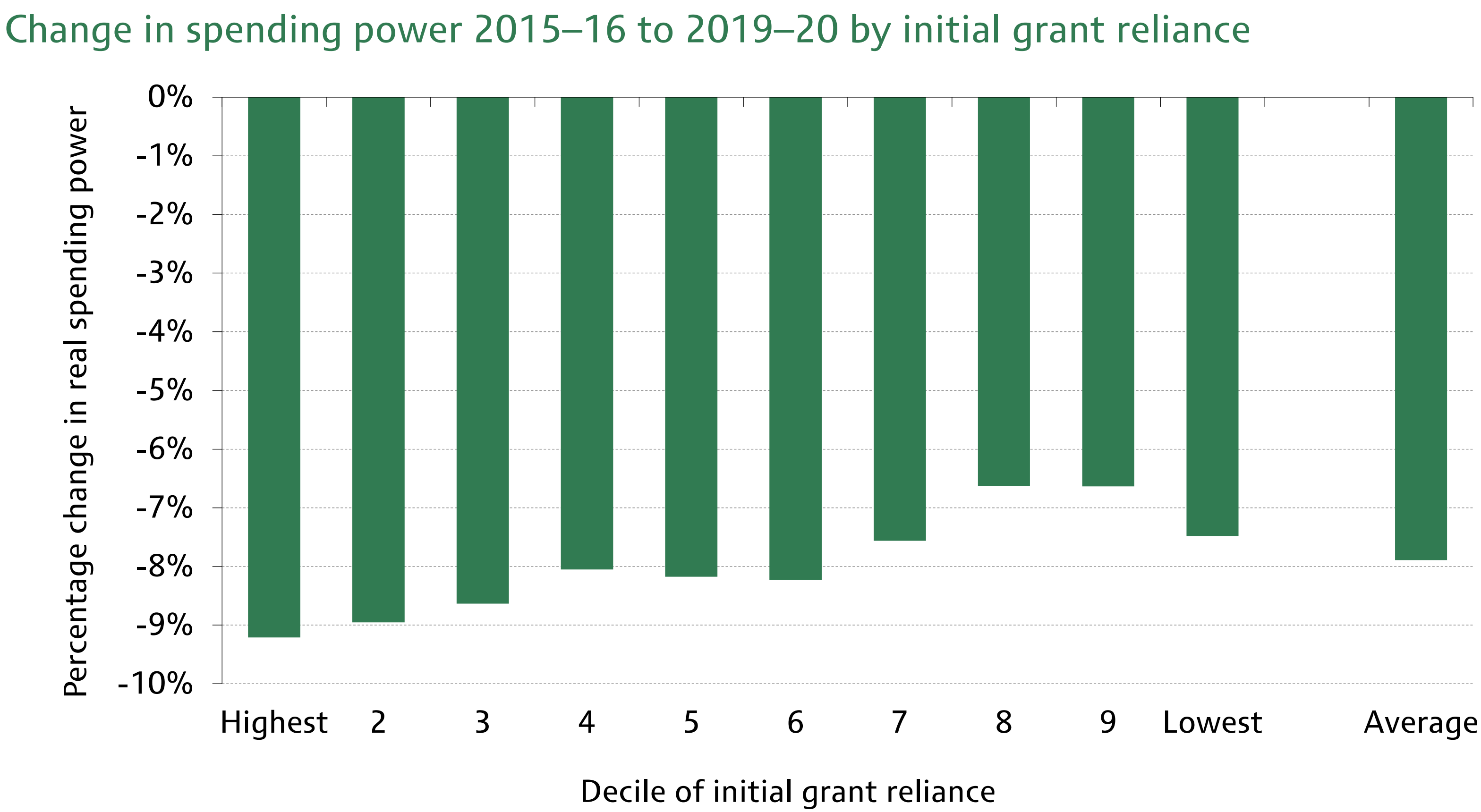
Central Beds – 11% cut

Worcestershire– 8% cut

Devon – 14% cut

Institute for Fiscal Studies

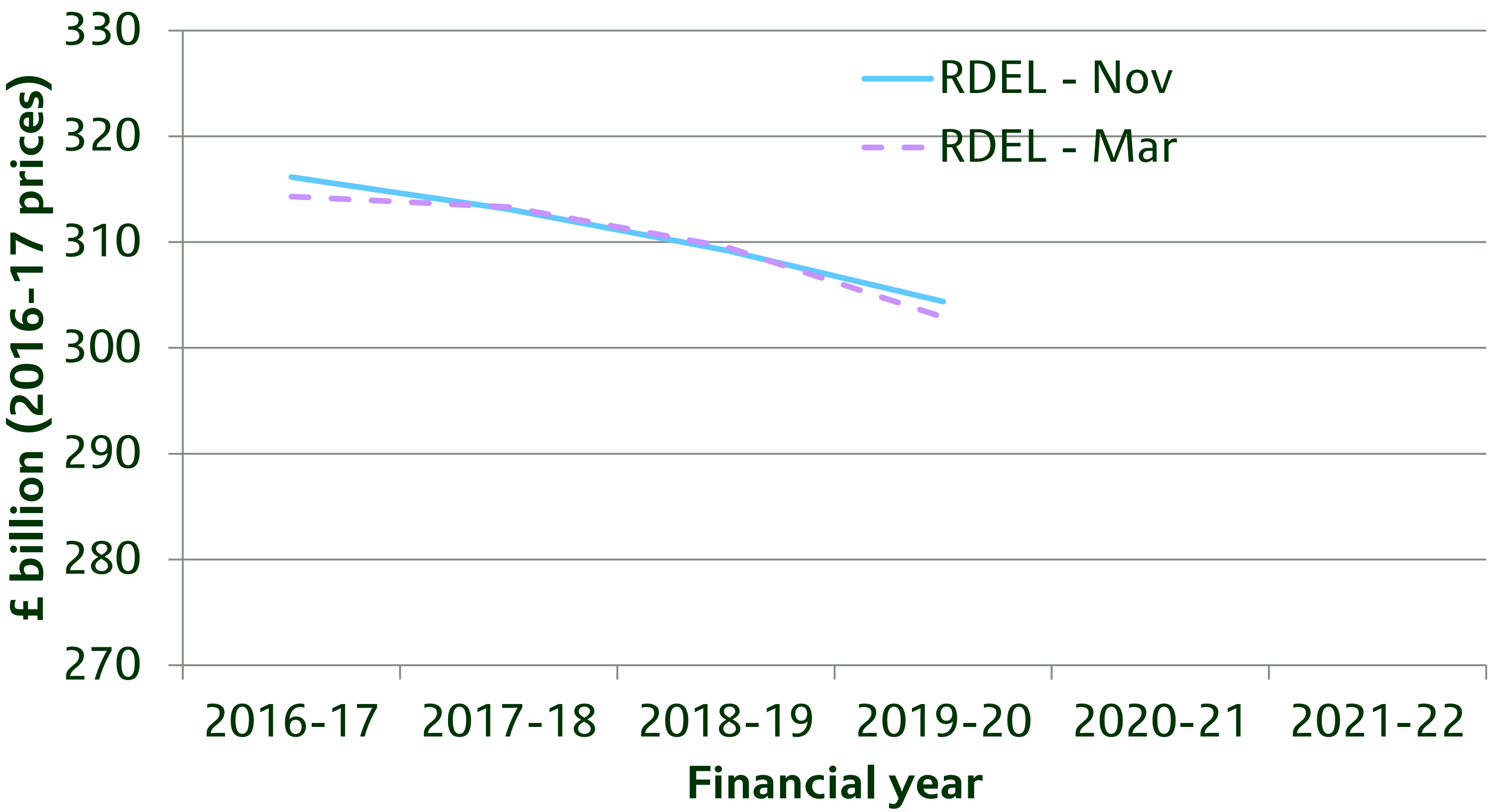
Changes to grant allocation mean cuts to spending will be more evenly distributed going forwards



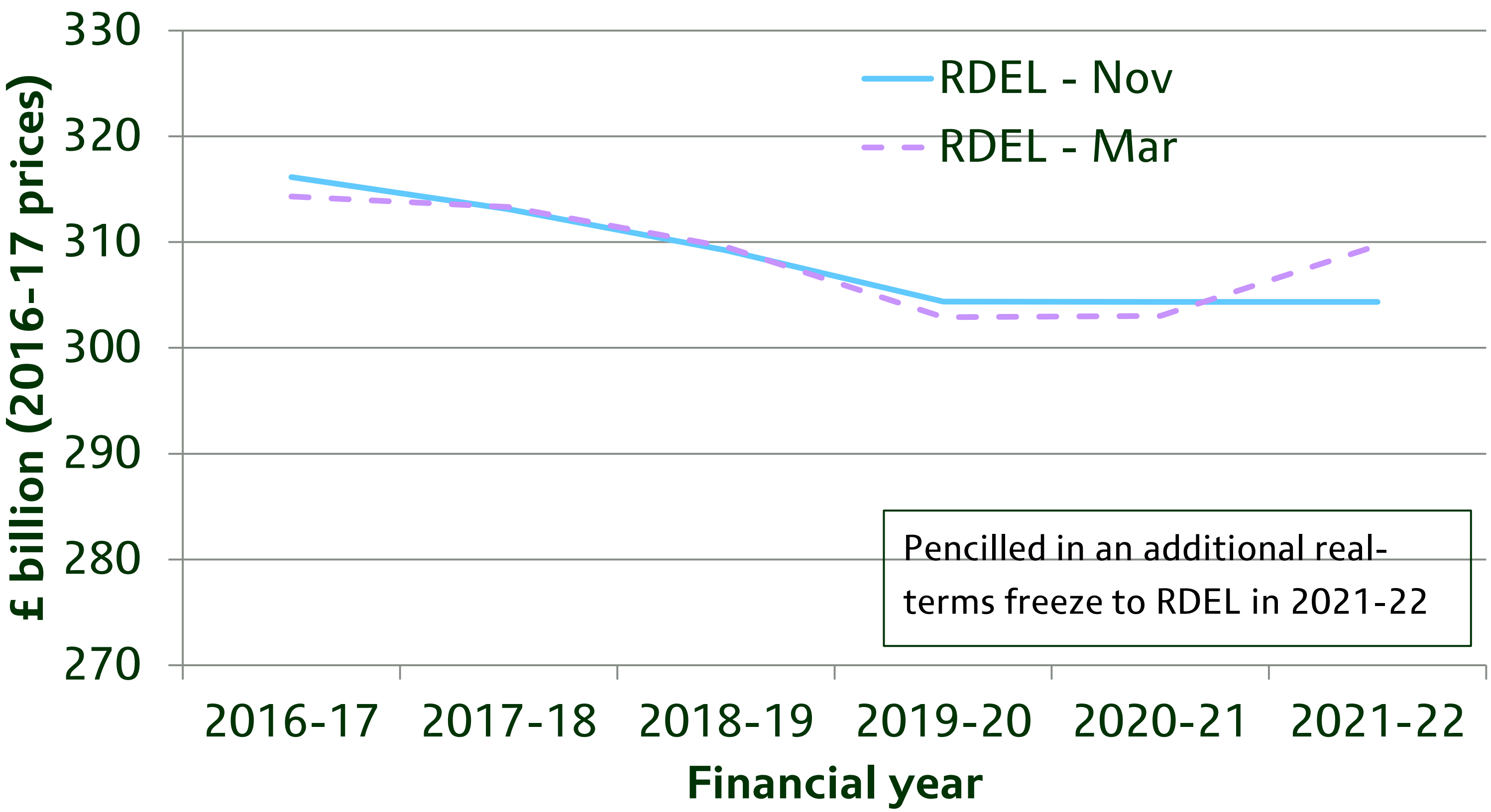
Source: IFS calculations using LG settlement 2016 (previously published December 2015)

Institute for Fiscal Studies

Current departmental spending – 2016-17 to 2021-22



Current departmental spending – 2016-17 to 2021-22



What about post-2020?

- Real-terms freeze in 2021-22 may mean cuts to some areas to fund increases to areas like NHS and overseas aid
- Councils could still be affected even though grants set to be abolished by 2020 and funded instead by local taxes
  - Could devolve additional responsibilities without commensurate funds
  - Government could impose a net ‘tariff’ on local government sector as a whole, drawing out money from business rates retention scheme
- Constraints on increases to local taxes
  - Business rates increases capped at CPI
  - Council tax referendum requirement; will social care precept remain?

New IFS Programme on Local Government Finance

- Rest of presentation draws on new IFS research programme
  - The current English business rates retention scheme (BRRS)
  - Moves to a 100% BRRS in England
  - What about reforms in Scotland and Wales?

- Lots more work in the coming years and months
  - Next output will look at business rates revaluation and appeals
  - Series of papers over next 12 months on design of 100% rates retention system
  - Work looking at what effects financial reform may have on councils' behaviour and local outcomes
  - Consider alternative or additional options for devolution

The business rates retention scheme (BRRS)

- Half of business rates revenues devolved to local government from 2013-14 onwards
- Local areas do not retain 50% of all business rates in their area
  - Initial assessment of how much revenues areas ‘need’
  - ‘Tariffs’ on areas with high revenues / low needs pay for ‘top-ups’ to areas with low revenues / high needs
  - These ‘tariffs’ and ‘top-ups’ then indexed in line with inflation
- Local areas retain up to 50% of the growth in business rates as a result of new developments, refurbishments etc
  - And bear 50% of revenue reductions
- Levies on revenue growth in high revenue areas fund ‘safety nets’ to stop areas where revenues fall seeing very big budget cuts

Gains and losses (2013-14 to 2016-17) relative to sharing in national growth in business rates

Institute for Fiscal Studies

Gains and losses (2013-14 to 2016-17) relative to sharing in national growth in business rates

Region	Cash gain/loss
East of England	+£61m
East Midlands	+£102m
West Midlands	+£30m
London	-£104m
North East	-£27m
North West	+£10m
South East	+£115m
South West	+£25m
Yorkshire & The Humber	+£77m

Institute for Fiscal Studies

Gains and losses (2013-14 to 2016-17) relative to sharing in national growth in business rates

Region	Cash gain/loss	% of overall councils' budgets (excluding education, public health and fire)
East of England	+£61m	+0.3%
East Midlands	+£102m	+0.7%
West Midlands	+£30m	+0.2%
London	-£104m	-0.2%
North East	-£27m	-0.3%
North West	+£10m	+0.0%
South East	+£115m	+0.4%
South West	+£25m	+0.1%
Yorkshire & The Humber	+£77m	+0.4%

Gains and losses (2013-14 to 2016-17) relative to sharing in national growth in business rates

LA Type	Cash gain/loss	% of overall councils' budgets (excluding education, public health and fire)
Counties	+£11m	+0.0%
Fire	-£7m	-0.1%
London	-£104m	-0.2%
Mets	-£3.5m	+0.0%
Shire Districts	+£291m	+2.4%
UAs	+£99m	+0.2%

Gains and losses (2013-14 to 2016-17) relative to sharing in national growth in business rates without levies and safety nets

LA Type	Cash gain/loss	% of overall councils' budgets (excluding education, public health and fire)
Counties	-£54m	-0.1%
Fire	-£8m	-0.1%
London	-£282m	-0.7%
Mets	-£65m	-0.2%
Shire Districts	+£356m	+2.9%
UAs	+£97m	+0.2%

Institute for Fiscal Studies

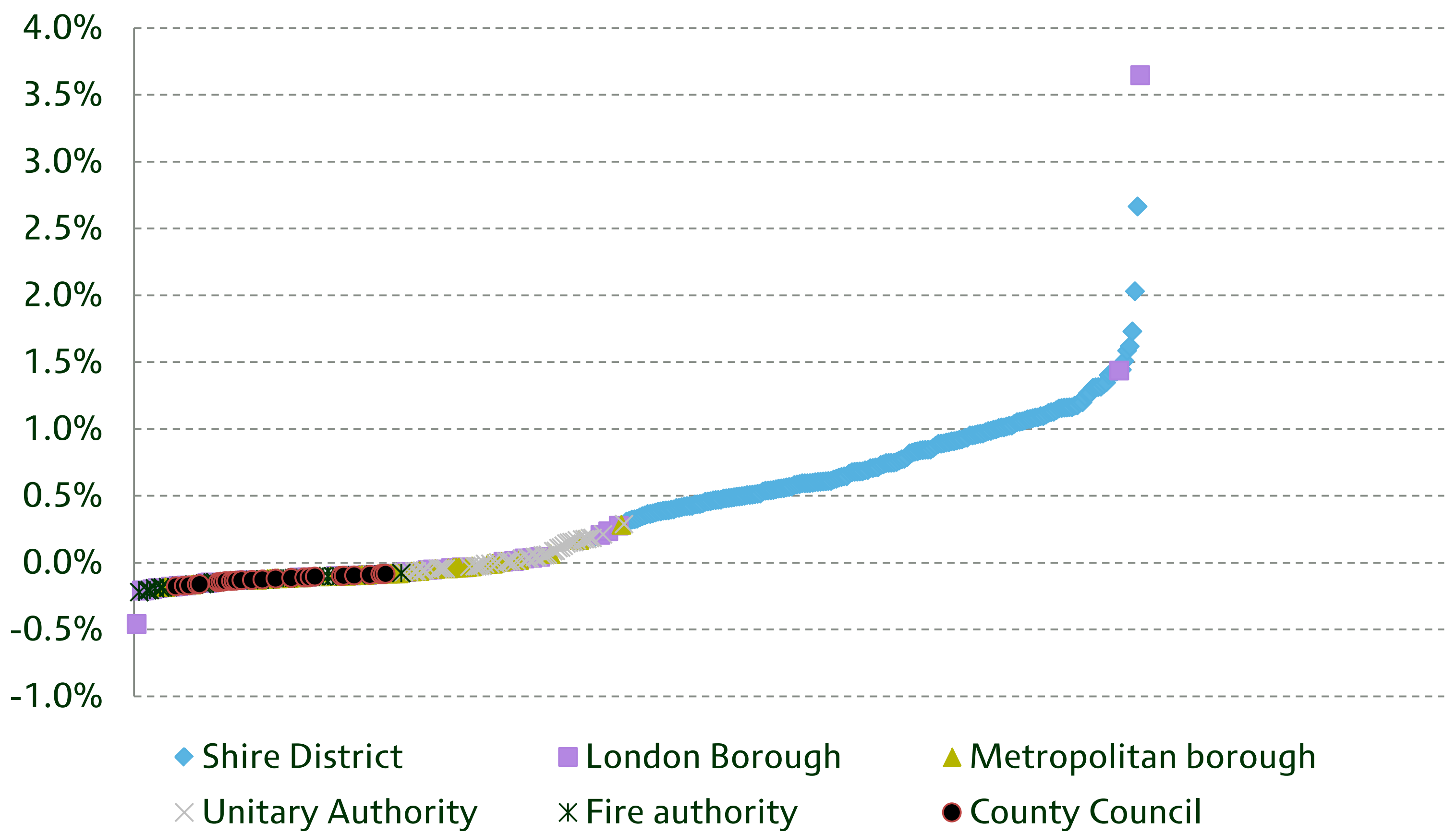
100% business rates retention

- Government has announced local areas will keep 100% of the growth in their business rates by 2020
  - Propose to abolish levies on growth in high revenue areas but keep some form of safety net system
- Stronger incentives for revenue growth but also more risk
  - Year-to-year volatility in revenues
  - Long-term divergence in revenues across councils
- Big unknown: are the incentives worth the risk?
  - Can councils do much to boost growth? Do incentives matter?

Dealing with divergence

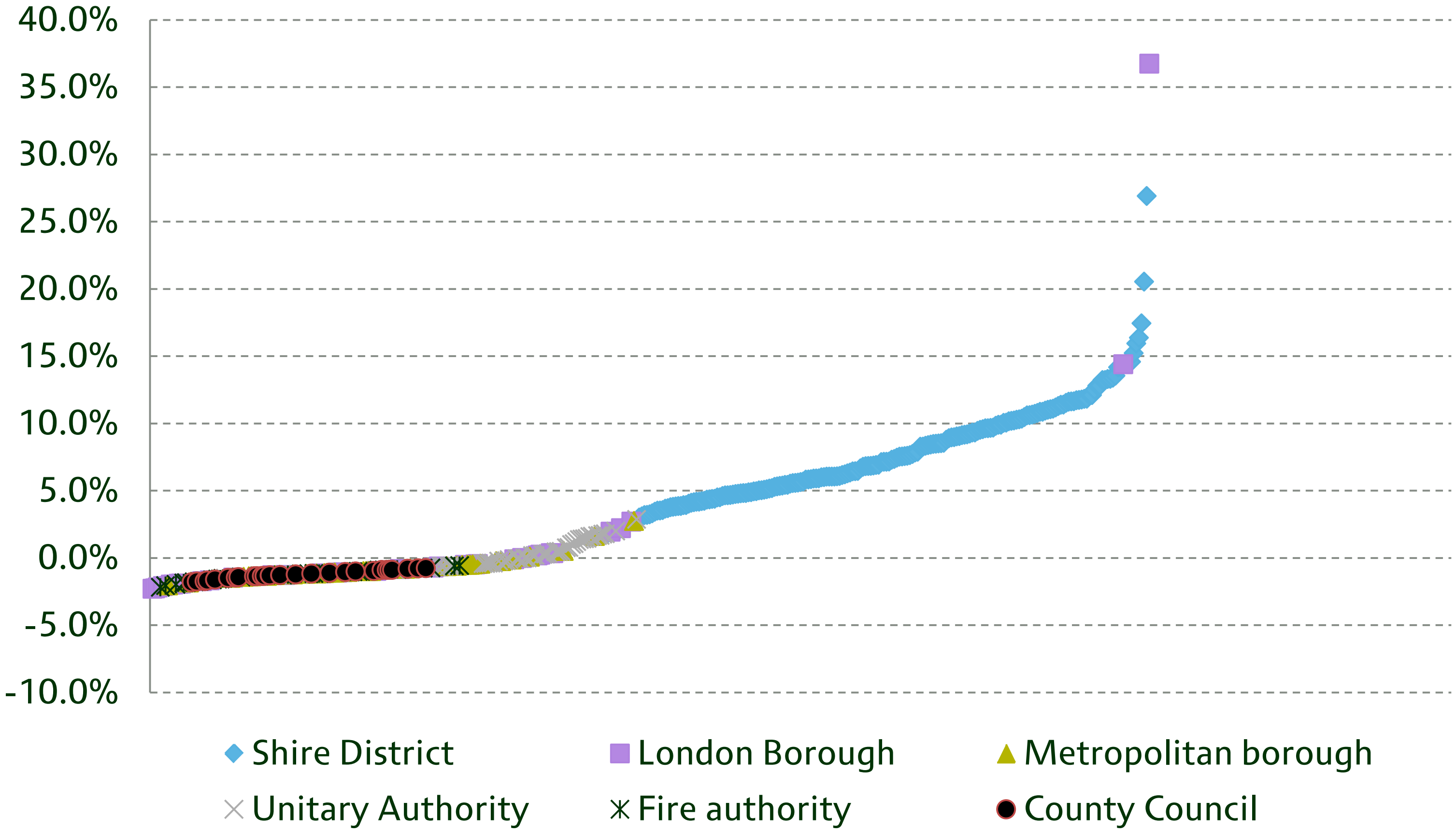
- Financial incentives require potential for divergence
- But if based on current 50% scheme, divergence will arise even if business rates grow same % in all of England
  - This is because ‘tariffs’ and ‘top-ups’ are indexed to inflation, but business rates can grow faster or slower than inflation
  - So amount of redistribution can fall or rise over time

Revenues grow 0.1% real-terms a year everywhere for 10 years



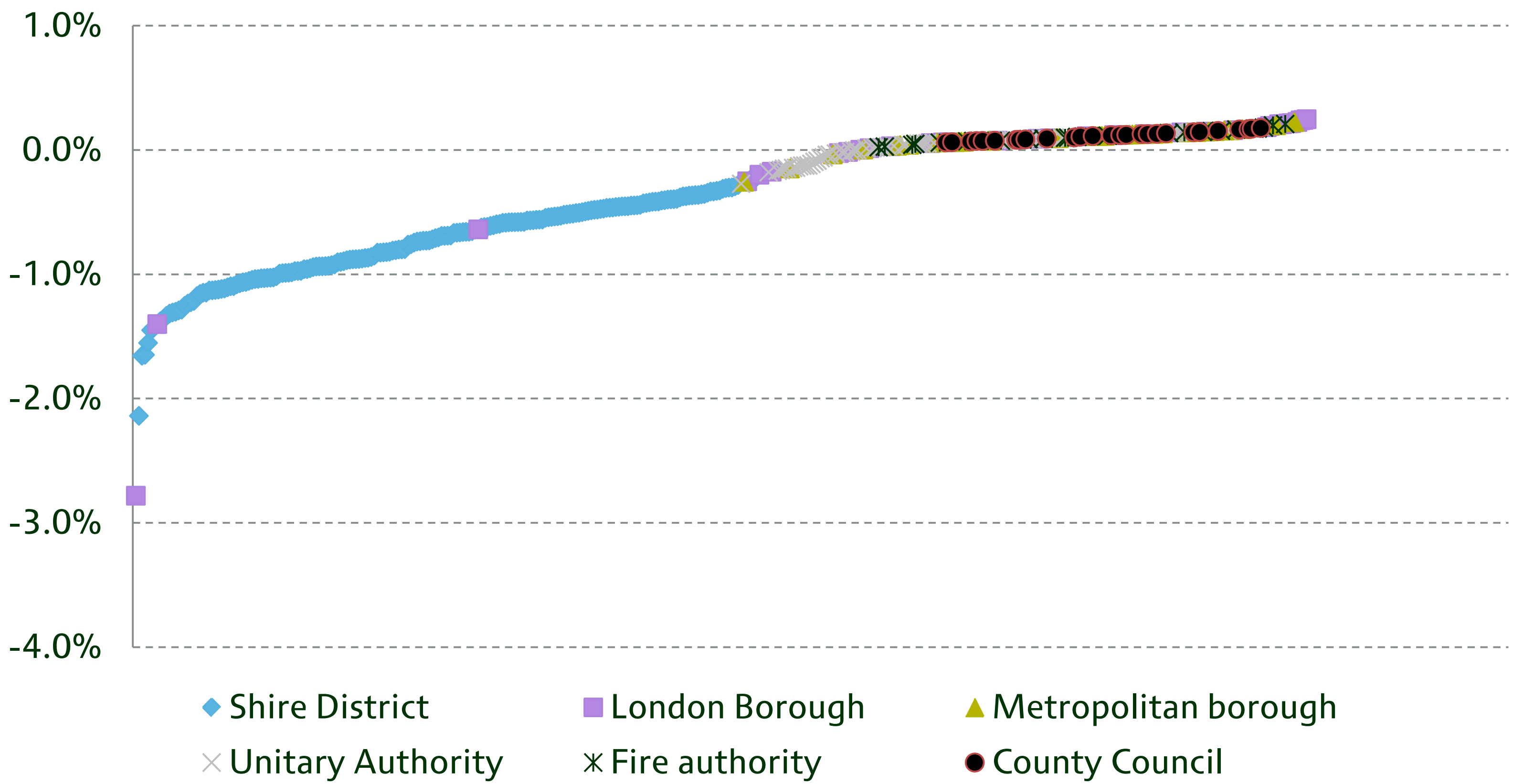
Institute for Fiscal Studies

Revenues grow 1% real-terms a year everywhere for 10 years



Institute for Fiscal Studies

Revenues *fall* 0.1% real-terms a year everywhere for 10 years



Institute for Fiscal Studies

Dealing with divergence

- Financial incentives require potential for divergence
- But if based on current 50% scheme, divergence will arise even if business rates grow same % in all of England
  - This is because ‘tariffs’ and ‘top-ups’ are indexed to inflation, but business rates can grow faster or slower than inflation
  - So amount of redistribution can fall or rise over time
- Indexing ‘tariffs’ and ‘top-ups’ to average growth addresses this
  - Redistribution keeps pace with average revenue growth

Resetting the system

- Without a full or partial reset of the system, divergence in funding could continue indefinitely
- How often should the system be ‘reset’? Factors to consider:
  - How fast and large divergence could be
  - Whether such divergence is result of local policy or outside factors
  - Judgement on how much divergence is acceptable
- Fixed resets can provide an incentive to delay development
  - Can a rolling reset be implemented?
  - Could there be different growth targets for areas based on historic growth in business rates bases?

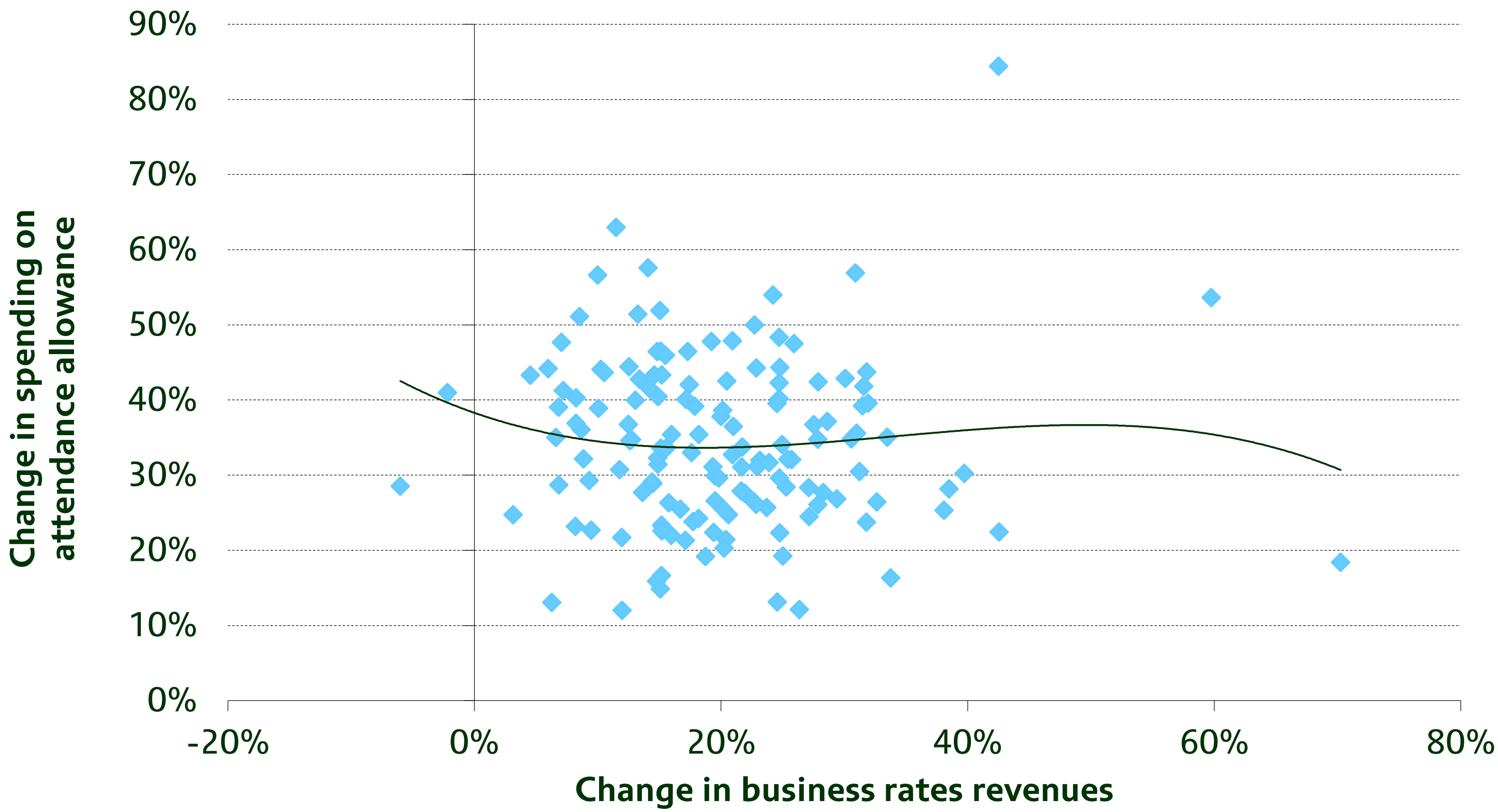
Institute for Fiscal Studies

Devolution of additional services to councils

- Business rates revenues to be devolved will be substantially more than general grants that will be abolished:
  - Around £10 billion to find
  - Roll in additional specific grants (e.g. Public Health) and/or additional responsibilities
- A range of criteria against which to judge candidates for devolution
  - Fit with existing services and expertise
  - Ability to tailor to local needs / preferences
  - Fit with economic development
  - Fit with resources available to local government
- Easier to ensure fit with resources in year 1 than subsequent years
  - And even if fits nationally, may not at local level given potential for spending need and revenue divergence

Institute for Fiscal Studies

Change in attendance allowance spending 2005-06 to 2010-11, by council in England



Institute for Fiscal Studies

Other key issues

- Method for calculating spending needs at resets
- Treatment of revaluations
- Appeals and provisions
- Operation in areas with multi-tier local government

Immediate issue with Reval and Appeals

- Next year will see first revaluation since BRRS in place
- Impact of revaluation will be "stripped out" of system by adjusting top-ups and tariffs
  - No immediate gains/losses if values up/down in local area
  - But will affect size of subsequent changes in business rates revenues (e.g. due to new development or demolition)
- Lots of occupiers likely to appeal against new valuations
- Business rates multiplier will be increased to raise revenues to pay for these appeals within business rates system
  - Councils allowed to keep extra raised to fund appeals provisions
  - But value of appeals likely to vary a lot and be concentrated in areas seeing biggest increase in rateable values
  - Windfall for some and unfunded appeals for others?

Institute for Fiscal Studies

Summary

- Big cuts in revenues and spending, especially in England
  - Cuts in England biggest for poorer, more grant-reliant councils
  - Not inevitable
- A major move towards provision of fiscal incentives for growth and development in English council funding system
  - Lots of ‘technical’ but important decisions to take
  - Are these incentives worth the risks?
- Different directions in Wales and Scotland
  - Funding system increasingly differs from England
  - Are there lessons to be learned for England? (or vice versa)

The Autumn Statement, Business Rates, and Local Government

5th December 2016

Local Government Association

The Local Government Finance and Devolution Consortium is generously supported by the following organisations, as well as a large group of local government bodies: