The impact of funding cuts and business rates retention in the North: latest IFS research

1st December 2016

MJ Future Forum North, Manchester

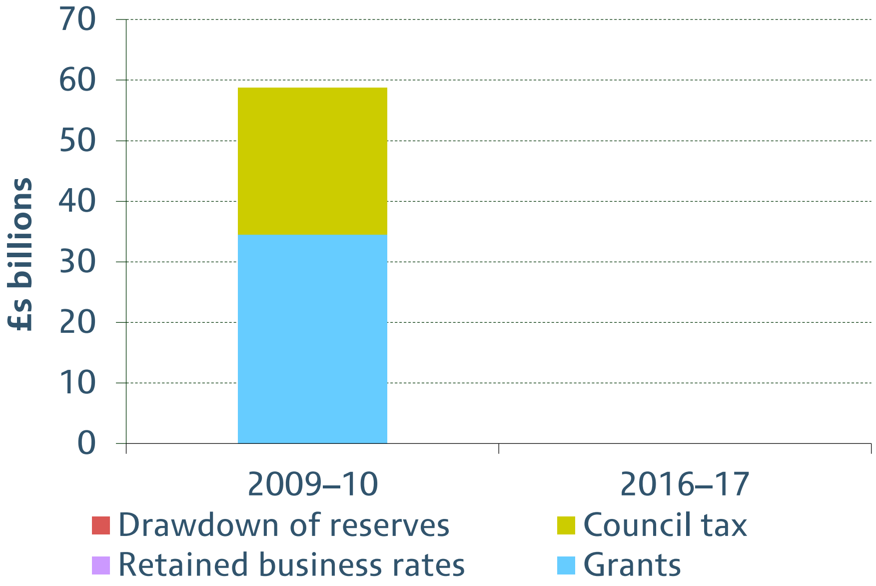
The Local Government Finance and Devolution Consortium is generously supported by the following organisations, as well as a large group of local government bodies:

New IFS Programme on Local Government Finance

- Presentation draws on our first report
  - Changes in councils' revenues and spending
  - 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
  - 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

English councils’ revenues

- Excluding grants for education, police and fire services, councils’ revenues in 2009-10 were £59 billion (in today’s prices)



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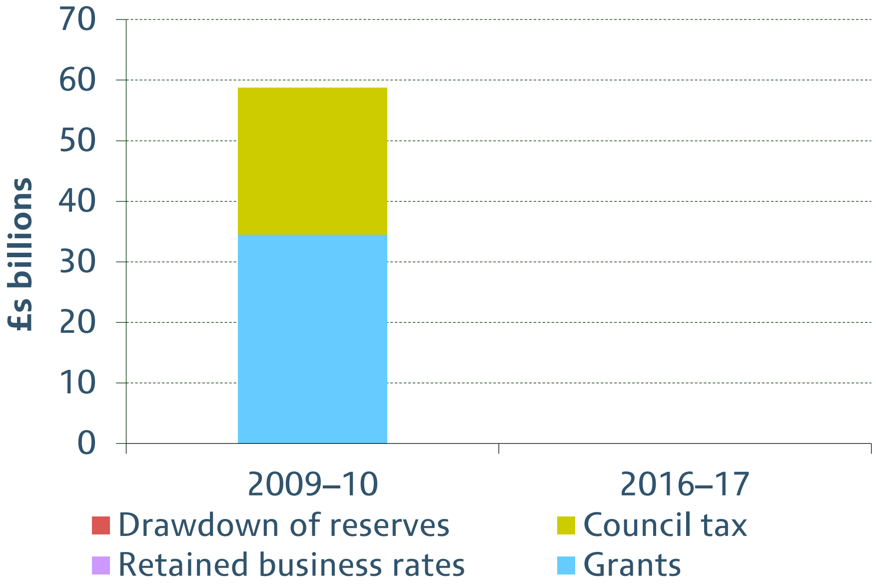

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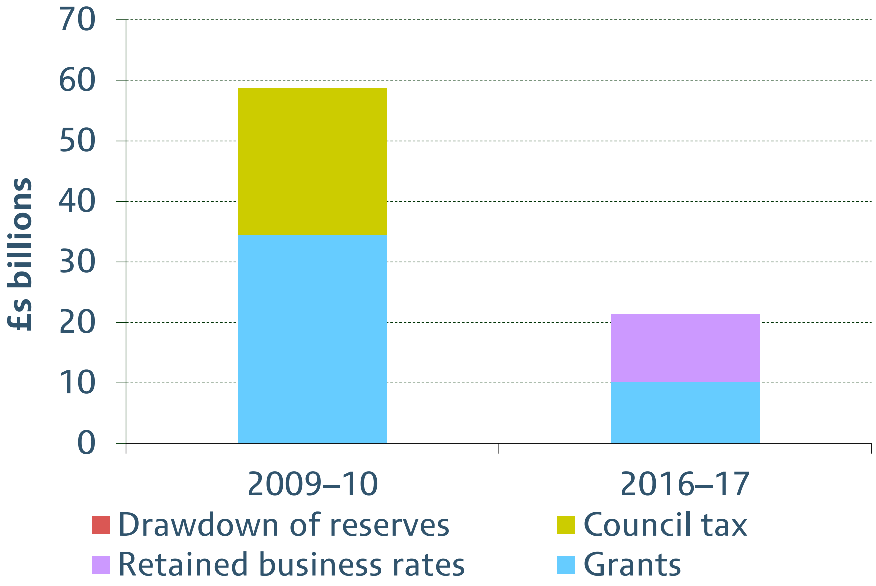

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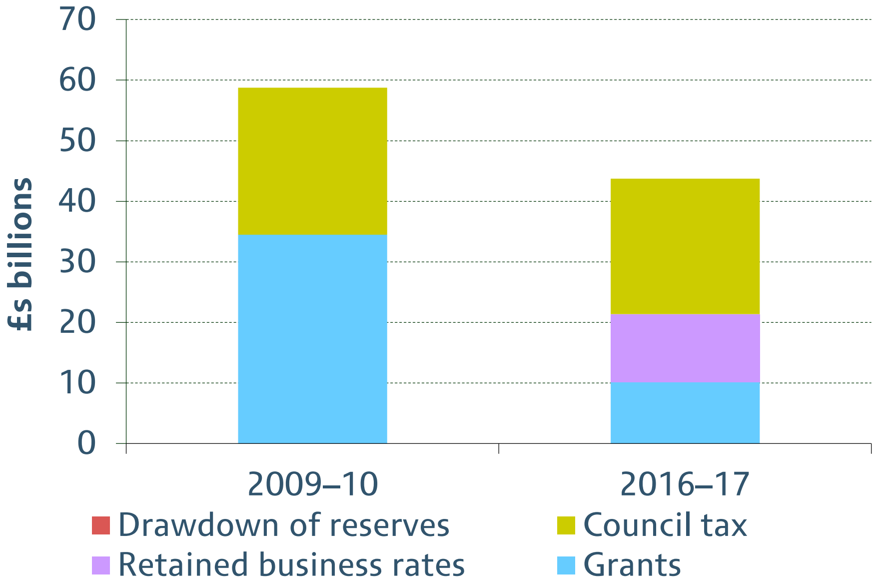

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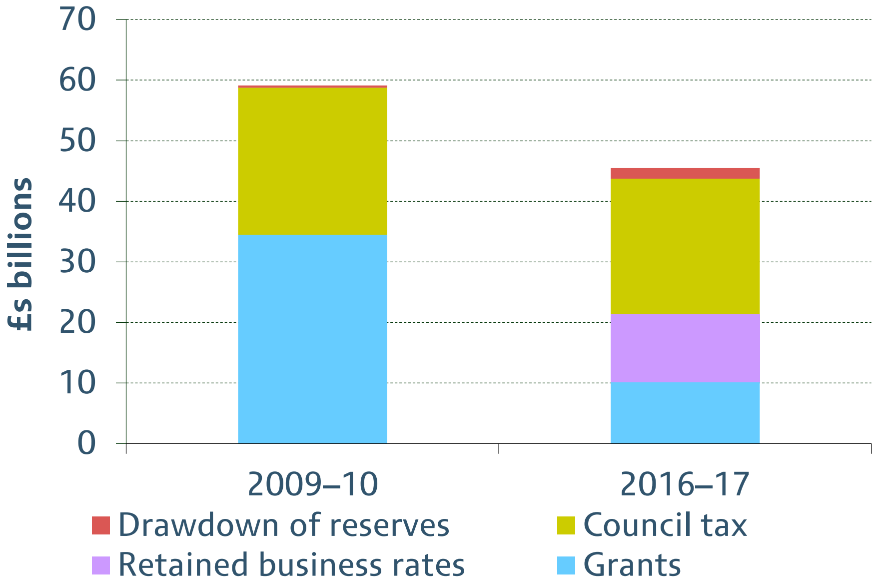

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  - Together, grants and newly part-localised business rates revenue down 38%
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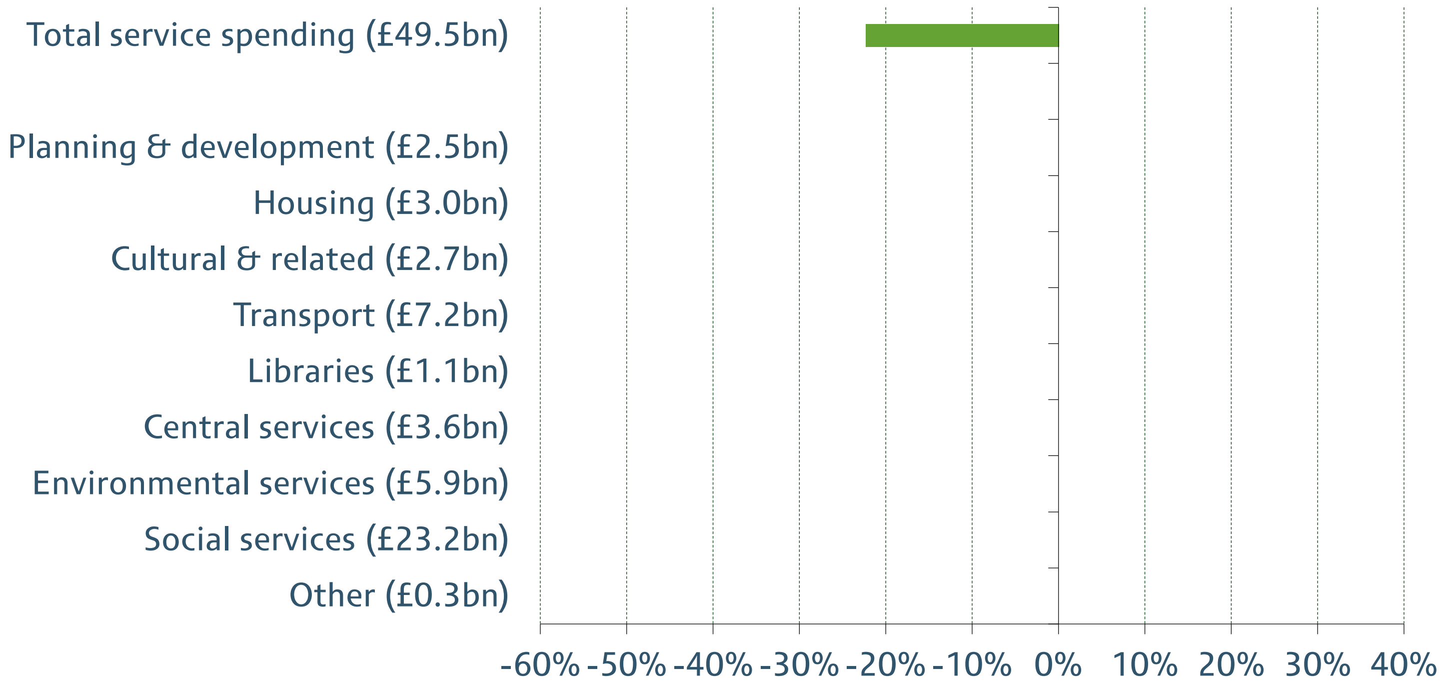
- Accounting for reserve draw-down: spending power down 23%

Cuts to council spending by service area in England between 2009-10 and 2016-17



Figures in brackets are amount spent in 2009-10

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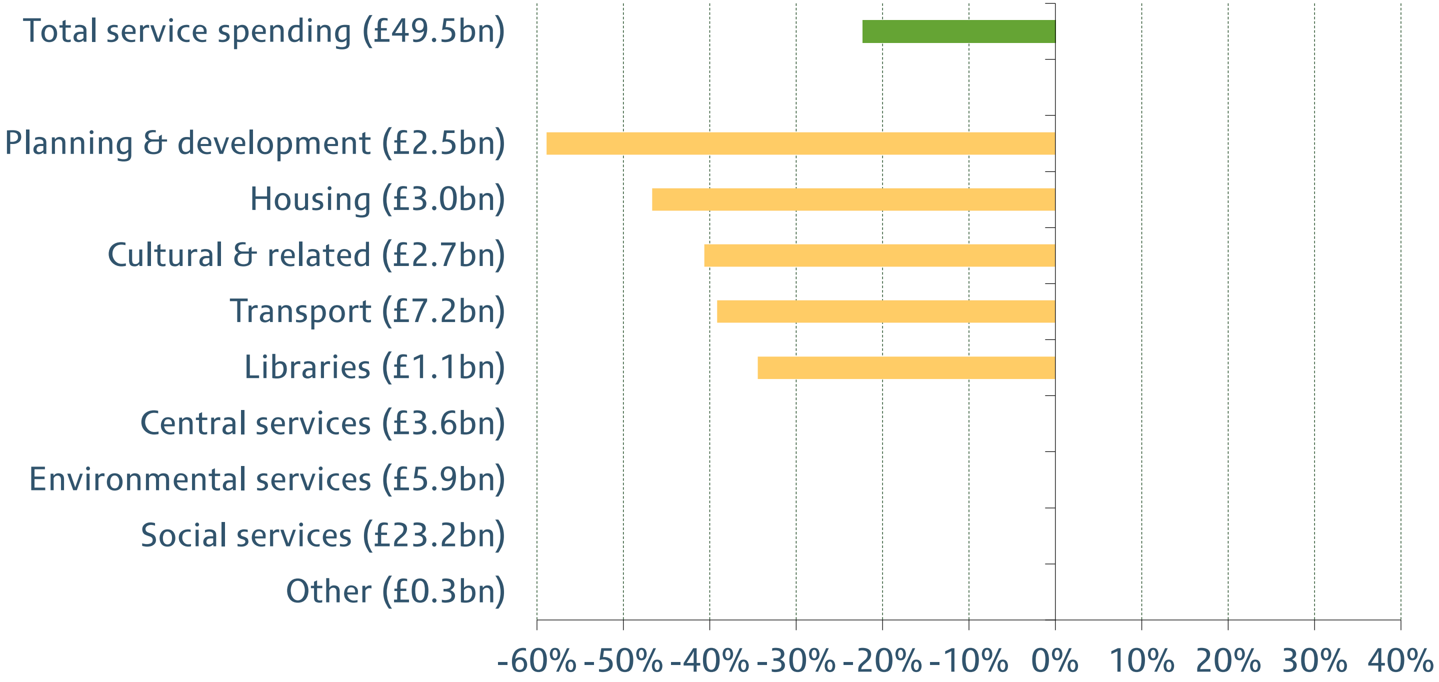

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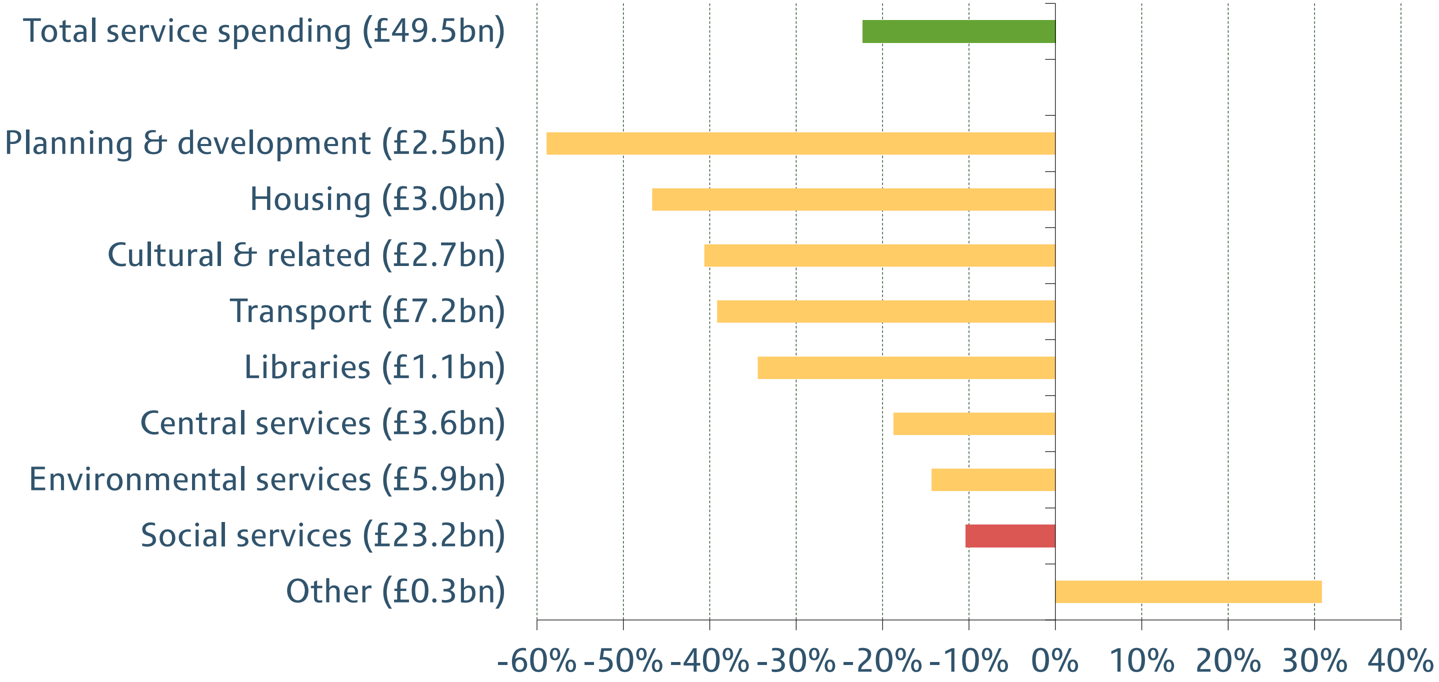

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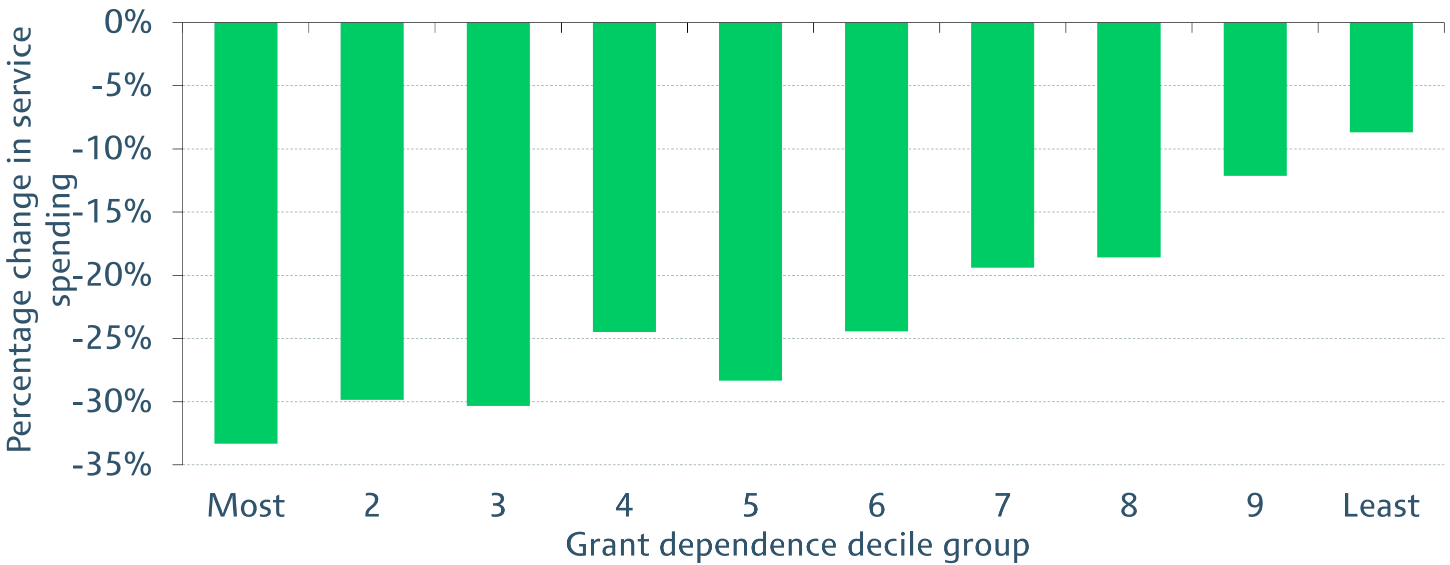
Cuts in Scotland and Wales (2009-10 to 2016-17)

- Cuts have been smaller in other parts of Great Britain
  - 15% in Scotland
  - 11.5% in Wales
- But pattern across services similar
  - Social services down 1%, planning and development down 30-50%
- Reflects smaller cuts in grants by devolved governments
  - In part because less protection for health in these countries (so cuts elsewhere less steep)
  - And in Scotland's case smaller cuts to overall government spending
- Figures reflect council tax freeze in Scotland (coming to end)
  - Council tax bills up substantially in real-terms in Wales

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



Manchester – 37% cut

Liverpool – 26% cut

South Tyneside – 44% cut

Bradford – 33% cut

Sheffield – 10% cut

Blackpool – 24% cut

Leeds – 27% cut

Rotherham – 33% cut

North Yorks – 11% cut

Staffs – 16% cut

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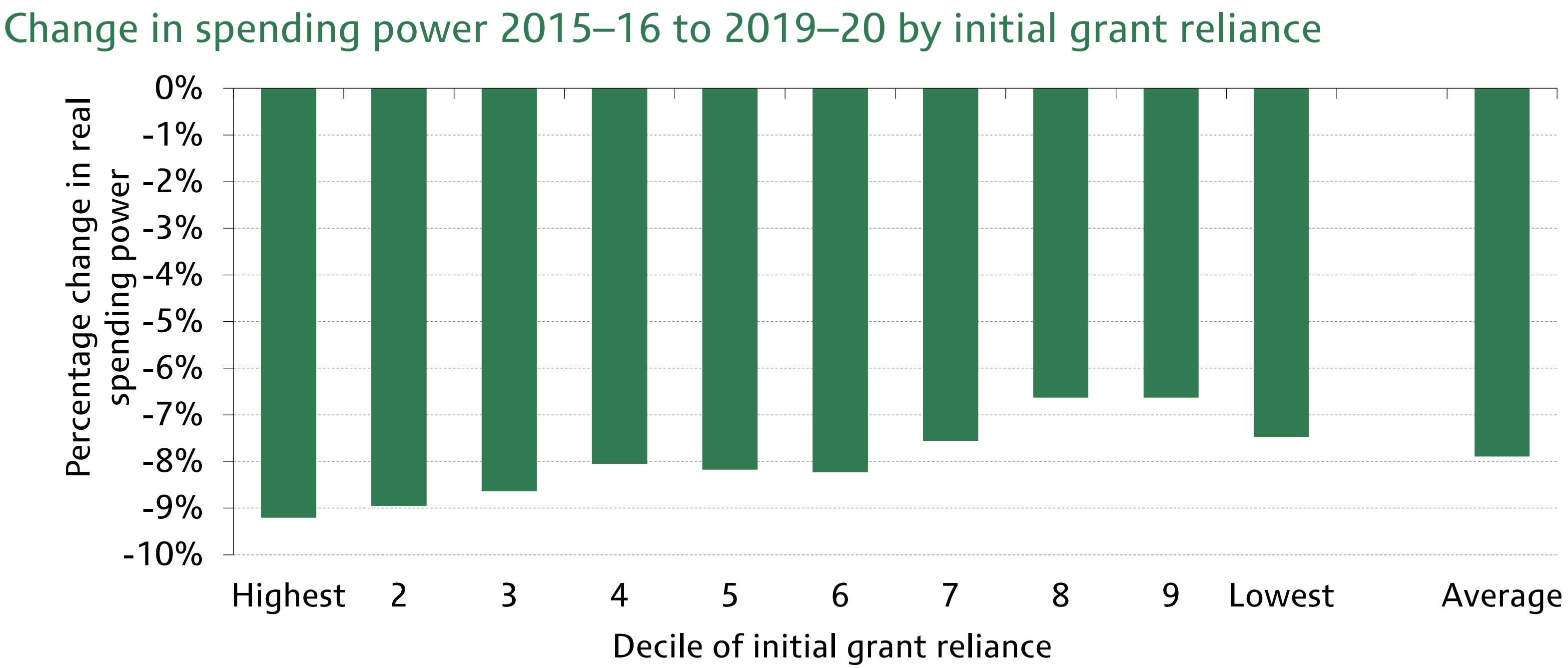
Changes to grant allocation mean cuts to spending will be more evenly distributed going forwards

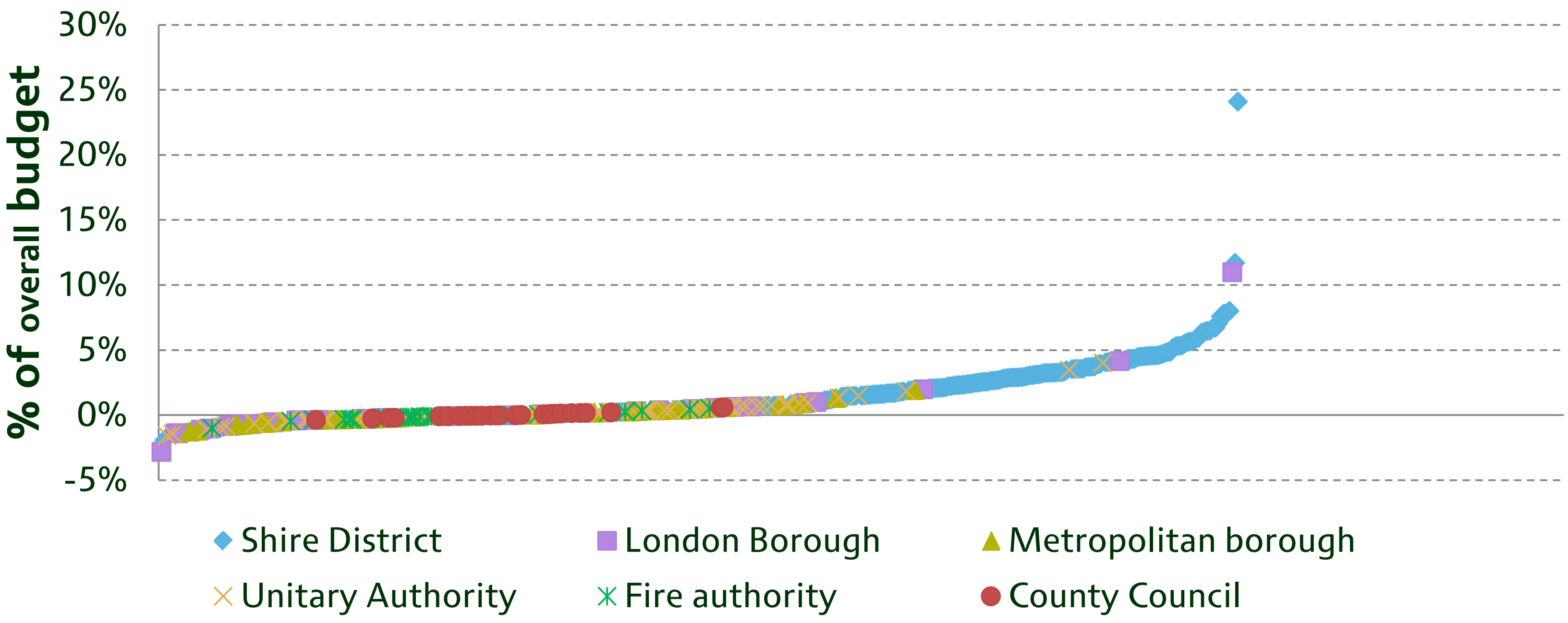


Source: IFS calculations using LG settlement 2016 (previously published December 2015)

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 big budget cuts

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



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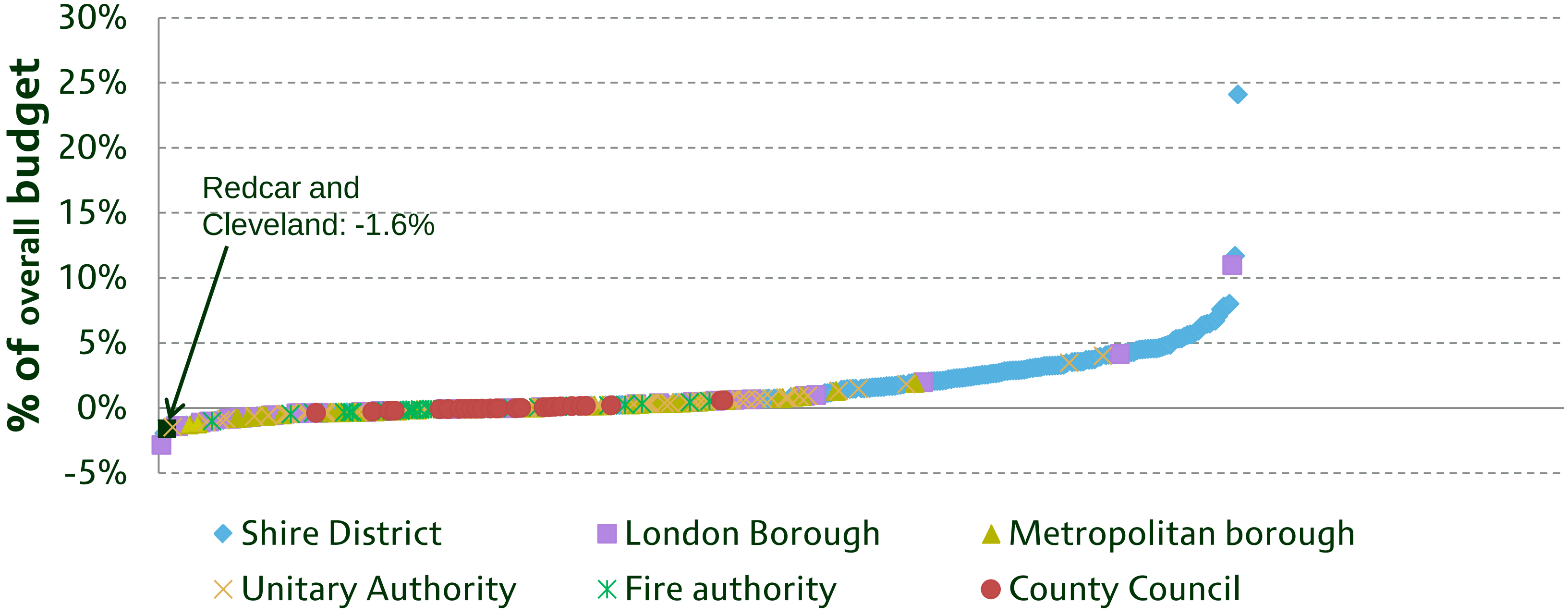

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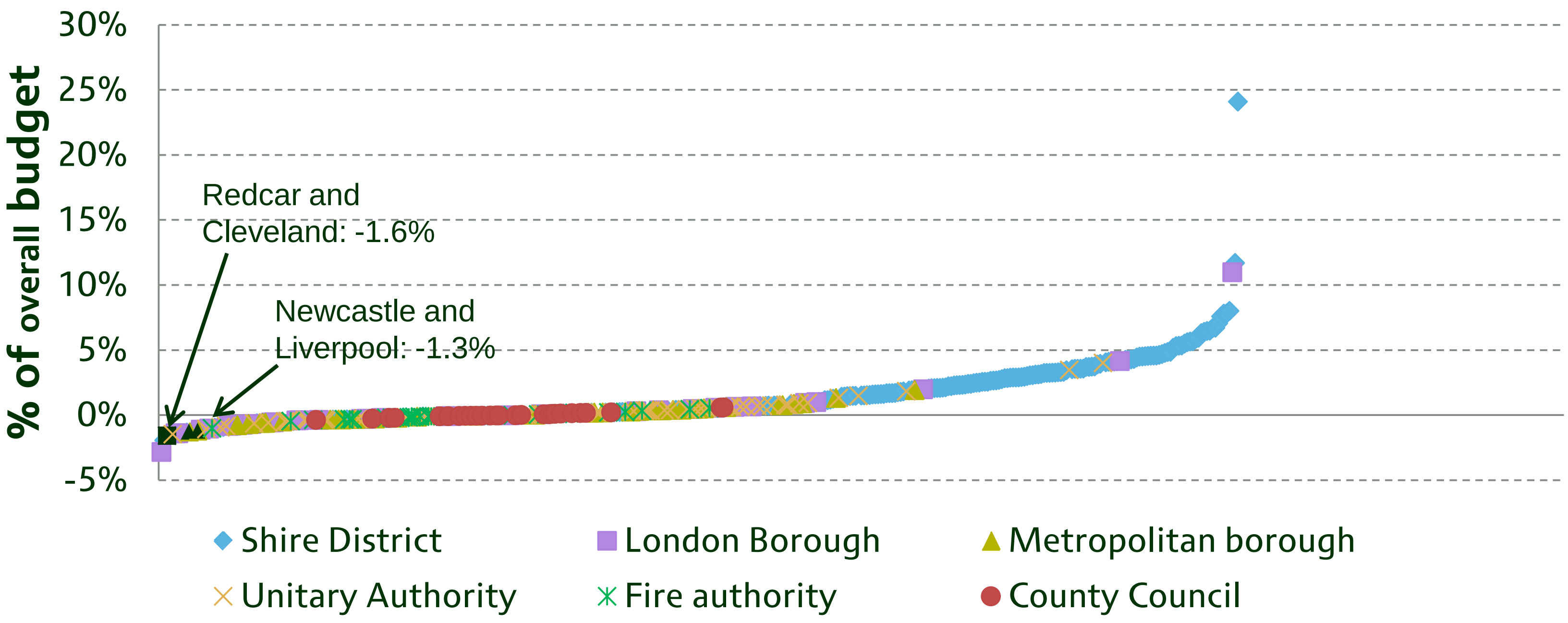

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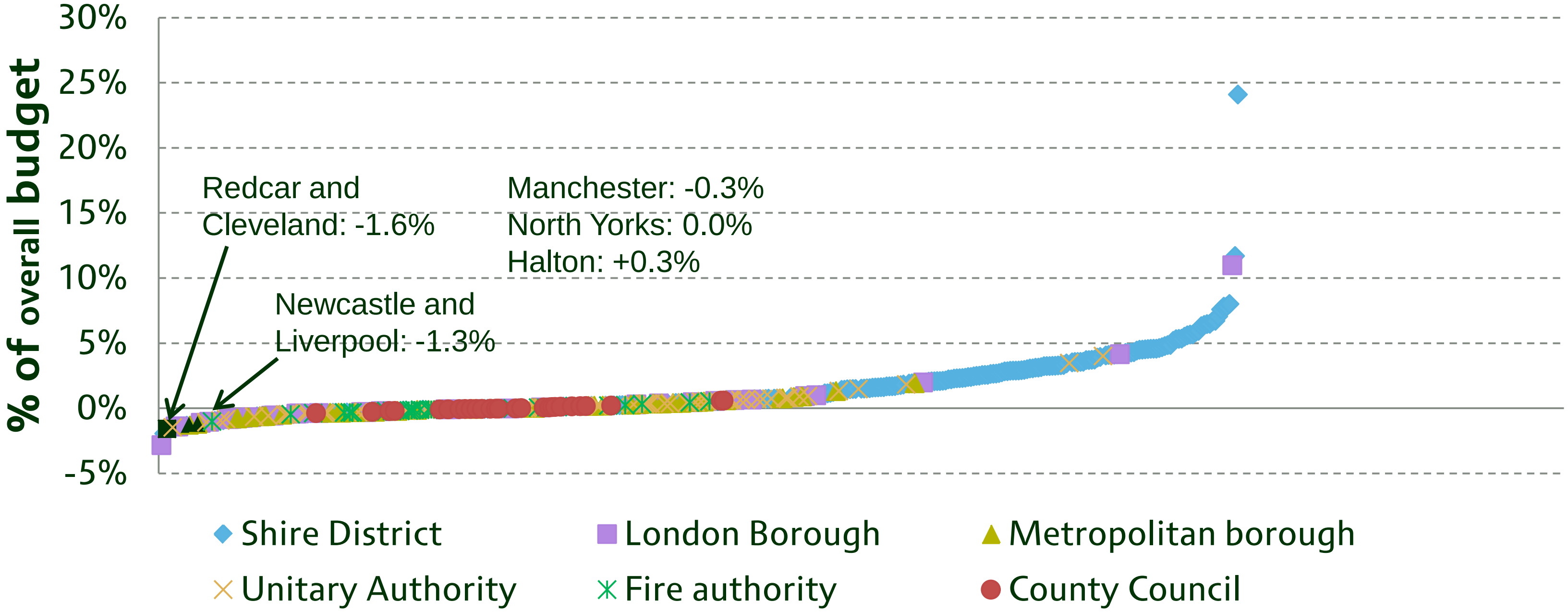

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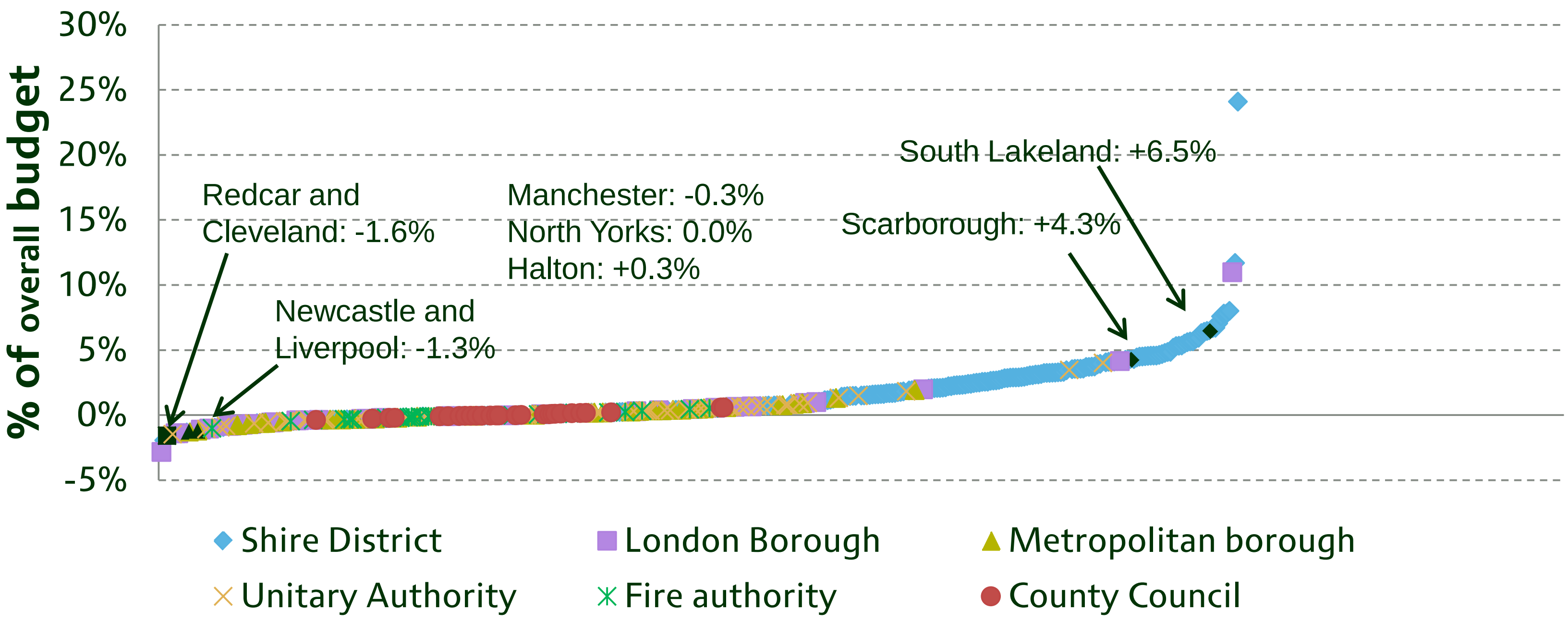

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Gains and losses (2013-14 to 2016-17) relative to sharing in national growth in business rates

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

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%

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

Region	Cash gain/loss	% of overall councils' budgets (excluding education, public health and fire)
East of England	+£43m	+0.2%
East Midlands	+£113m	+0.8%
West Midlands	+£34m	+0.2%
London	-£282m	-0.7%
North East	-£56m	-0.6%
North West	-£56m	-0.2%
South East	+£154m	+0.4%
South West	+£25m	+0.1%
Yorkshire & The Humber	+£69m	+0.4%

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

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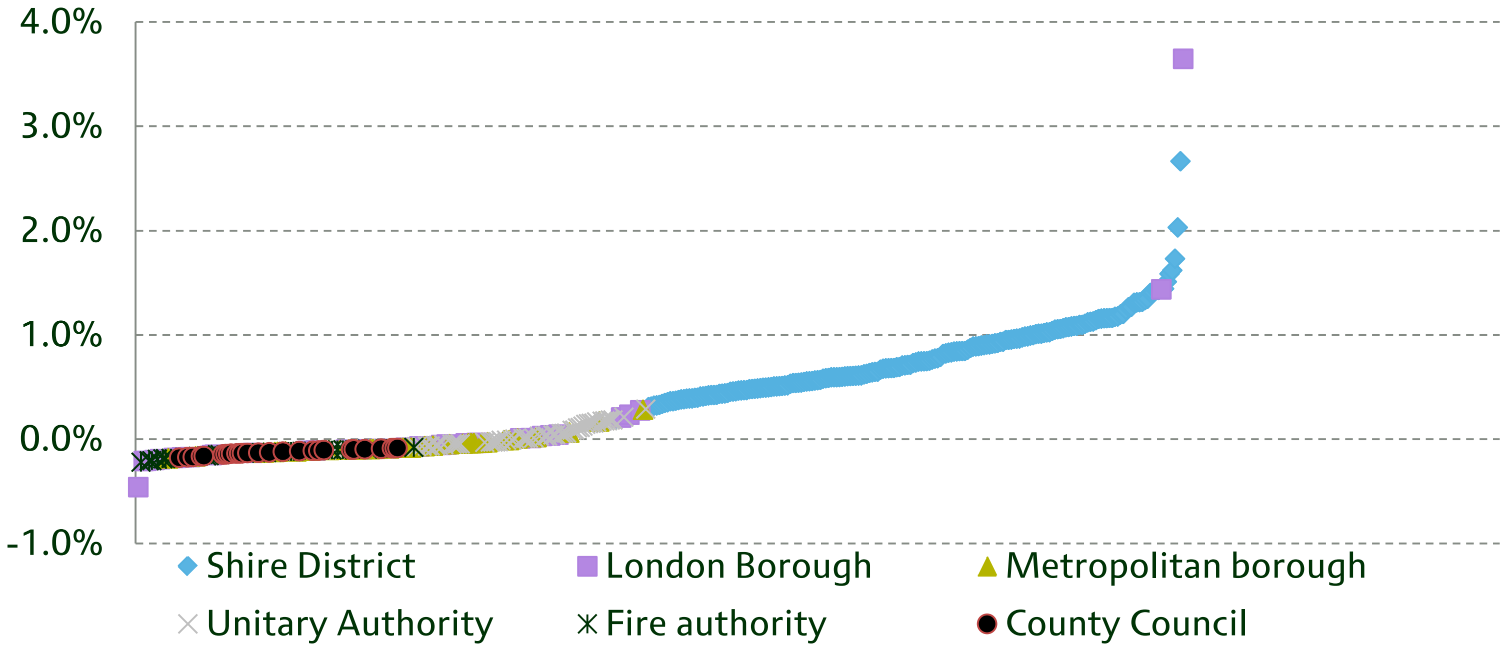
Revenues grow 0.1% real-terms a year everywhere for 10 years



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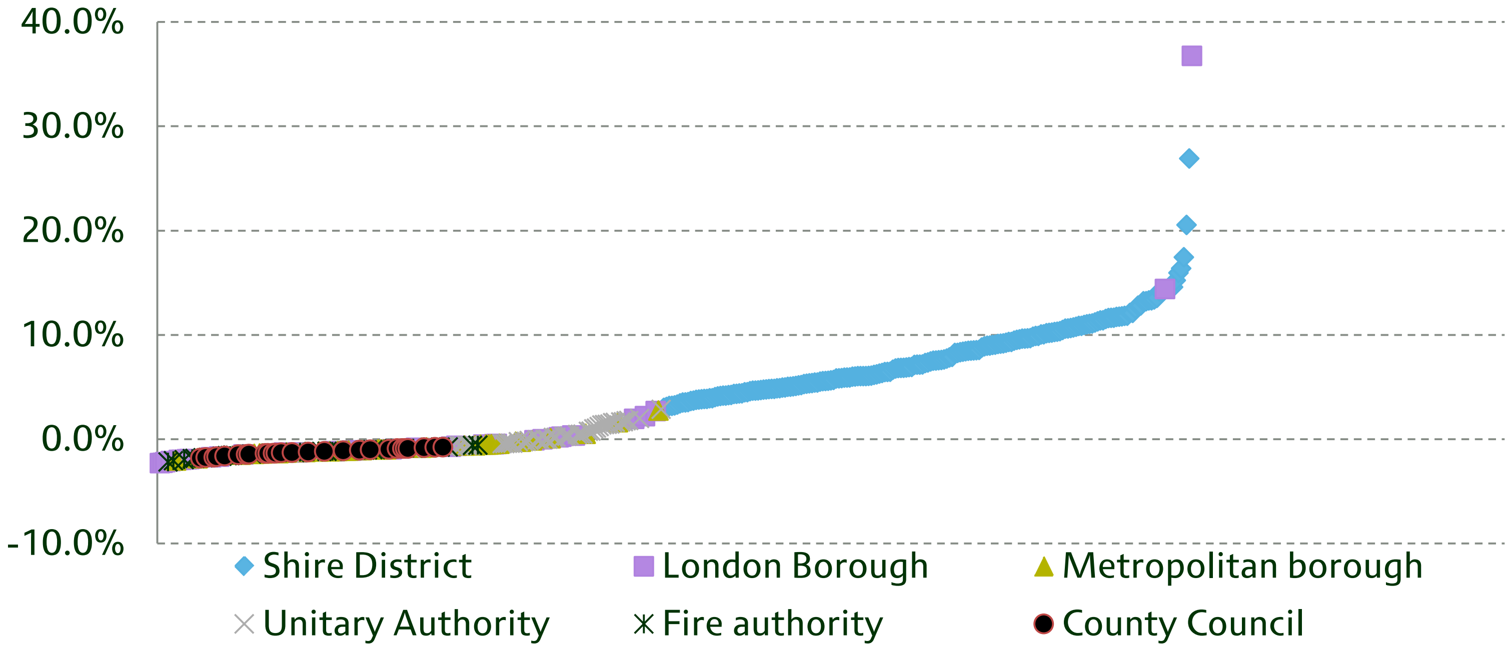
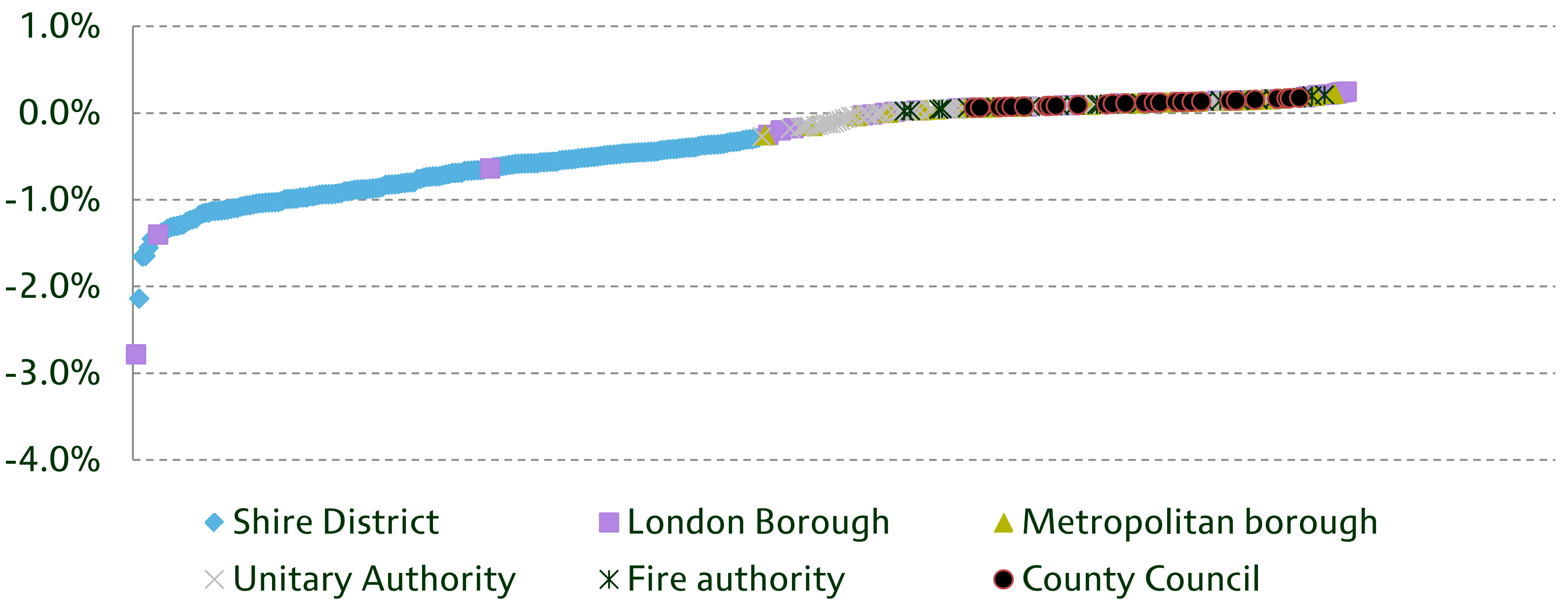


Revenues *fall* 0.1% real-terms a year everywhere for 10 years



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  - 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

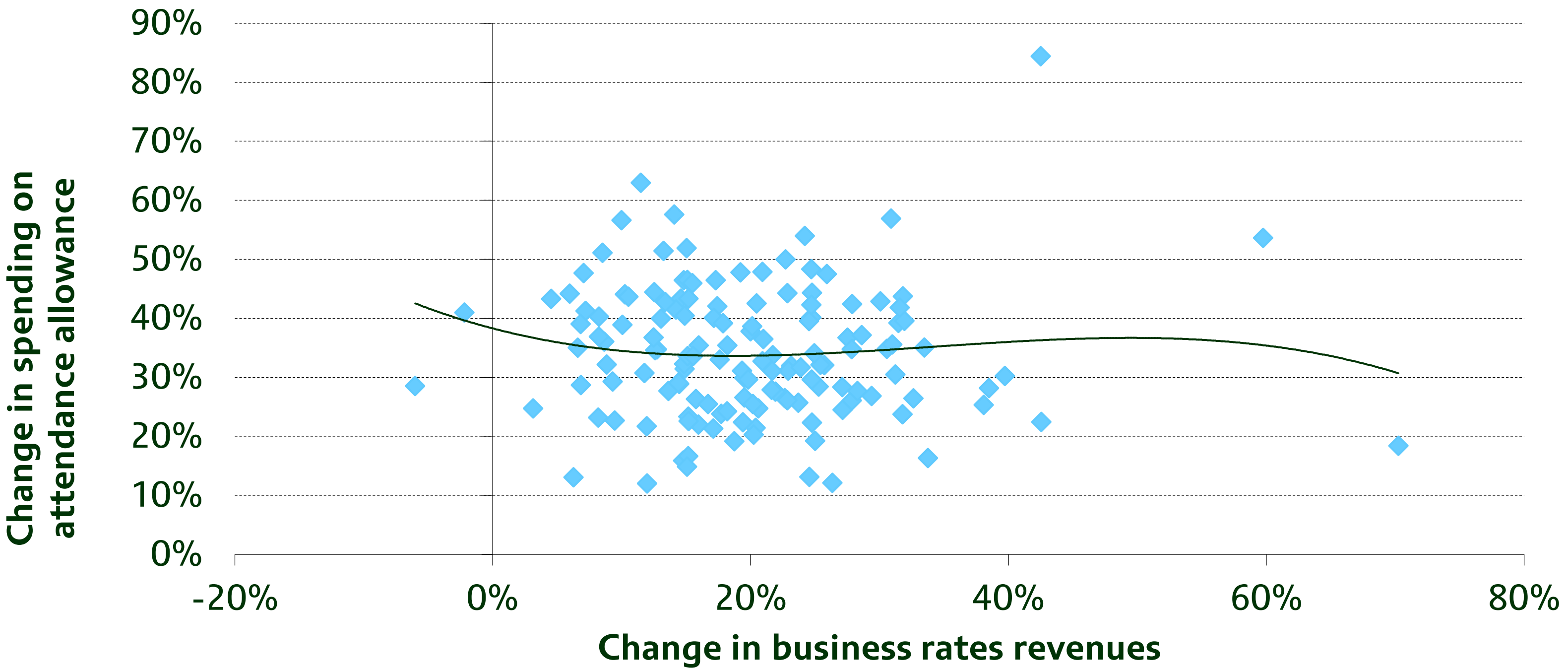
Resetting the system

- 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?

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 grants 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

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



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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 issues with Reval and Appeals

- Next year will see first revaluation since BRRS in place
- Impact 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?

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)

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