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
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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

- Planning & development (£2.5bn)
- Housing (£3.0bn)
- Cultural & related (£2.7bn)
- Transport (£7.2bn)
- Libraries (£1.1bn)
- Central services (£3.6bn)
- Environmental services (£5.9bn)
- Social services (£23.2bn)
- Other (£0.3bn)

Figures in brackets are amount spent in 2009-10
Cuts to council spending by service area in England between 2009-10 and 2016-17

- Total service spending (£49.5bn)
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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

- Most: Manchester – 37% cut
- 2: Liverpool – 26% cut
- 3: South Tyneside – 44% cut
- 4: Bradford – 33% cut
- 5: Sheffield – 10% cut
- 6: Blackpool – 24% cut
- 7: North Yorks – 11% cut
- 8: Leeds – 27% cut
- 9: Rotherham – 33% cut
- Least: Staffs – 16% cut
Changes to grant allocation mean cuts to spending will be more evenly distributed going forwards

Change in spending power 2015–16 to 2019–20 by initial grant reliance

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

% of overall budget

-5% 0% 5% 10% 15% 20% 25% 30%

Shire District London Borough Metropolitan borough
Unitary Authority Fire authority County Council
Gains and losses (2013-14 to 2016-17) relative to sharing in national growth in business rates

- Redcar and Cleveland: -1.6%
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Shire District
London Borough
Metro. borough
Unitary Authority
Fire authority
County Council

Redcar and Cleveland: -1.6%
Newcastle and Liverpool: -1.3%
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- Shire District
- London Borough
- Metropolitan borough
- Unitary Authority
- Fire authority
- County Council

Redcar and Cleveland: -1.6%
Manchester: -0.3%
North Yorks: 0.0%
Halton: +0.3%
Newcastle and Liverpool: -1.3%
Gains and losses (2013-14 to 2016-17) relative to sharing in national growth in business rates

Scarborough: +4.3%
Redcar and Cleveland: -1.6%
Newcastle and Liverpool: -1.3%
Manchester: -0.3%
North Yorks: 0.0%
Halton: +0.3%
South Lakeland: +6.5%

% of overall budget

Shire District
London Borough
Metropolitan borough
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County Council
### Gains and losses (2013-14 to 2016-17) relative to sharing in national growth in business rates

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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

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<tr>
<td>East of England</td>
<td>+£43m</td>
<td>+0.2%</td>
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<tr>
<td>East Midlands</td>
<td>+£113m</td>
<td>+0.8%</td>
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<tr>
<td>West Midlands</td>
<td>+£34m</td>
<td>+0.2%</td>
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<tr>
<td>London</td>
<td>-£282m</td>
<td>-0.7%</td>
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<tr>
<td>North East</td>
<td>-£56m</td>
<td>-0.6%</td>
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</tr>
<tr>
<td>South East</td>
<td>+£154m</td>
<td>+0.4%</td>
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<td>+£25m</td>
<td>+0.1%</td>
</tr>
<tr>
<td>Yorkshire &amp; The Humber</td>
<td>+£69m</td>
<td>+0.4%</td>
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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.
Revenues grow 1% real-terms a year everywhere for 10 years
Revenues *fall* 0.1% real-terms a year everywhere for 10 years.
Dealing with divergence

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• 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
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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