LOCAL GOVERNMENT CHRONICLE

Localising business rates: the case against

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We face the most radical reform of local government finance in two generations and yet we are reduced to adopting positions on “set asides”, “reset periods”, tariffs and damping.

Aside from those few relatively resource rich areas facing exogenous pressures for growth, the much-hoped-for move to greater fiscal autonomy for English local government will seem hollow in five years. The LGA may have won major technical concessions from government but the significance of the change of direction in how English councils are to be funded cannot be overstated.

It is worth asking how we got to this point. For there is a powerful case against localising business rates. And in the midst of a “balance sheet recession” – where companies pay off debt rather than invest in new facilities – this case is stronger still. But unfortunately, very few commentators sought to engage with the core economics of the government’s proposal. Odd really, given the weighty and impressive work of, first Sir Frank Layfield in the 1970s and then, thirty years later, by Sir Michael Lyons. These reviews started with first principles; with the services that ought to be provided at local level by democratically accountable councils, and then enquired about the type of taxes that could sustainably support these services.

For top-tier councils, more than half of their spending is on adult social care and children’s social care. That is why, if these local services are to be financed more from local resources, they need to be based upon a tax with a reasonably predictable and, hopefully, a buoyant yield. And it is therefore why the emerging agenda is about, “the functions and services that are to be funded from retained business rates”. Local public goods and quality of life services might sensibly rest on local business property taxes - but quality of life-chance services such as children’s social care? Hardly.

My council has spent the best part of two decades encouraging development and inward investment. Despite that the borough remains largely residential. In fact, the police station in the middle of Lewisham town centre is the council’s ninth largest business rate payer. Behind the police station is a bowling alley. Above the bowling alley is a suite of 1970s offices that houses a media company. And guess what? This company is Lewisham’s biggest

business ratepayer by far. In 2008, it paid £80,000 a year in business rates - this year it pays £2.8m (£1m more than any other in Lewisham). And yet it underwent no development, it did not expand its occupation, nor did it intensify the use of its site. So why do they do they pay so much now compared to three years ago? Basically, the company had to pay business rates on the fibre optic cable that it laid throughout London. Their offices in Lewisham are simply the biggest they have in London, so Lewisham gets the £2.8m. Of course we don't benefit directly from this vagary in business rate payments. That's because we pay their rates into the national pool which then gets re-allocated back to councils on a needs basis. This system has worked well for decades but it walls councils off from appreciating the practical constraints and pressures on business growth.

Encouraging inward investment is a sensible economic growth strategy for localities. Alongside strategies to strengthen existing businesses, it brings vitality and productivity to areas giving them hope and opportunity. Somewhat differing traditions of economic 'boosterism' have always underpinned attempts by political leaders in American and British cities. That's a sign of healthy politics about place and sub-national economies. But linking local tax revenues to 'boosterism' is an altogether different proposition.

The underlying economic case for the change that is being introduced stems from the theories of Charles Tiebout, an American economic geographer who, in the 1950s, suggested a model of how local government in the USA should compete to prevent "free-riding" (this is where residents of an area pay local taxes to finance local facilities and benefits that are then used by people who are not resident in that area). The problem is that his theory has very weak applicability in England - a country with much higher population concentration and with significantly greater economic spillover effects between local areas than is the case in the USA. While 33% of people in England live in our ten largest urban areas, in the USA just 8% of their population live in their largest ten cities.

As with all arguments there is a balance to be struck. There are four powerful arguments in favour of the government's changes. However, there are at least as many counter-arguments against the changes.

The case for change

1) It encourages local government to think more actively about what helps local businesses thrive and it therefore makes their economic development

strategies more realistic (particularly in respect of how best to achieve and support industrial sector "balance" or "clusters" in their localities)

2) It connects local government more into the need to address and buttress economic growth locally rather than simply "milk" economic growth

3) It makes businesses more sensitive to the tax demands and service offerings of different localities to drive more efficient outcomes from their locational decisions

4) It connects the volume and pattern of local government activities more to the underlying health of local economies rather than being a national service locally delivered

The case against change

1) The economic geography of England is wholly unrelated to local government jurisdictions. Aside from the largest authorities, most council areas are simply too small to act as functional economic areas; and England's urbanised population produces enormous spillover and leakage effects across localities

2) The reason why local business rates rise or fall is wholly unrelated to the nature of the services that are to be funded from their yield. There is no respectable argument for linking a Council's ability to finance the social care of adults and children to their success in attracting inward investment from businesses. Hence this change in funding may herald larger changes in local government functions in England.

3) Business locational decisions favour clustering as well as the geographical separation of HQ, plant and logistics on grounds of cost and access to markets. Businesses intensify their use of land and/or they relocate because of underlying economic factors that have precious little to do with local government policies.

4) A long-term "balance sheet" recession is exactly the worst time for English local government to be more reliant on local business rate income (as our American colleagues have found out to their cost over the past three years)

5) Finally, there is little evidence to support the argument that when local authorities agree planning applications from businesses they increase the volume of business rates they then collect. A multi-year statistical

examination of these two factors has failed to show any relationship whatsoever - largely because the degree of churn within the economy is greater than the marginal investments made in any short-term period.

In the English context, a shift away from a needs-based and resource-standardised approach lacks economic coherence. What's more the system that is being developed will necessitate intricate rules of Byzantine complexity (involving TiFs, tiers, zones and levies, etc) that will confuse accountabilities further.

Solving one problem in a hurried fashion, often just makes another smaller problem bigger. The Office for Budget Responsibility's recent economic assessment shows how tax on the occupation of land was the same in volume terms for businesses as for households (with both contributing some 1.6% of GDP for each of the next five years in business rates and council tax respectively). By the end of the forecast period, people and businesses will pay about £30bn each to government by way of taxes to occupy land; at the same time people will be paying £208bn in income tax while businesses will be paying £48bn in corporation tax. Does this balance seem right at all? With the current media focus on corporation tax it is highly likely that companies will start to focus squarely on their business rate bill (which amounts to an average of 40% of their net tax bill). In the deepest squeeze for a century, local councils in England need to help local businesses and communities survive and thrive. Shifting to a one-dimensional model of economic change based on business rate localisation is simply the wrong approach.

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