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Local Government Resource Review:

Submission from the Centre for Cities, October 2011

Since the announcement of the Local Government Resource Review (LGRR) consultation, the Centre for Cities has been an active researcher, collaborator and discussant about the proposed measures. We have heard concerns and suggestions from the Department for Communities and Local Government (DCLG) and other government officials, members of local government, property developers, investors, infrastructure providers and academics. Our research provides a well-rounded and thoughtful response to the LGRR consultation, as summarised here.

Our report, *Room for Improvement*, set out a wider context for understanding how the design of the LGRR can affect economic growth. *Capital Gains* evaluates whether London will see growth from business rates retention and highlights the importance of pooling revenues for larger projects. Lastly, a report we release at the end of October on Tax Increment Financing calls for the use of Option 2 TIF and outlines specific options for light-touch rationing, a key concern for DCLG in the design of the system. We would encourage DCLG to utilise these resources in their decision-making processes.

Cities are an important part of how local government finance reform will affect economic growth and local governance in England; thus their position should be highlighted in DCLG's considerations. Within England, cities contain 62 percent of jobs over a mere 14 percent of the land. Cities are also a major generator of business rates revenues; approximately £13 billion of the £19 billion in rates revenues collected in 2010/11 were collected in England's 56 cities. As advocates for and partners with English cities, the Centre would like to emphasise their important position in these reforms.

Designing a good incentive

First, we would like to highlight design elements within a business rate retention system which should be implemented. Below, we have designated seven factors which create a good incentive:

- Sufficiently large
- Affect decisions at the margin
- No thresholds
- Incentivise the intended behaviour
- Target appropriate decision maker
- Easy to understand and transparent
- Predictable and long-term

With these objectives in mind, Government can develop the right kind of incentives to drive economic growth across the UK. We would especially like to highlight the **importance of clarity**; incentives should be easy to understand and predictable. We believe there is room for more clarity in the proposed methods for business rates retention and TIF. We are very cautious that Government should not design another LABGI system which is too complicated and unpredictable, to the point of losing utility. The intricate systems of top-ups and tariffs, baselines and resets add complexity to the system and make funding streams unpredictable, thus reducing the functionality of business rates retention and TIF for authorities and investors. Also, incentives should target decision-makers; this is especially relevant in two-tier authorities. Regardless of the policy, using these policy design elements will create incentives to change behaviours and support growth.

Recommendations for Business Rates Retention

The design of business rates retention is integral to its success in providing authorities with an incentive to develop and the funds necessary to support growth. Setting a baseline such that no authority is worse off in the beginning is fair, but Government must recognise that, in any incentive system, there will be those who benefit more than others. First, determining the rate of local retention will be integral to creating a large enough incentive and balancing it with maintaining a national pot. We believe a sufficient and balanced rate would be between 40 and 60 percent to be retained locally. Second, local authorities should be rewarded at the level at which they take decisions. Finally, incentivising authorities to pool business rates funds to support wider growth at the LEP level will enhance the ability of authorities to tackle challenges they face across their functional economic area and provide stability to the system.

Recommendations for Tax Increment Financing

Government must first and foremost recognise that TIF will not be right for every city. TIF is best used where there is insufficient infrastructure to unlock economic potential, and it should be used where there is sufficient growth potential. An Option 2 TIF is the only viable TIF option under the proposed design of the reforms. The ringfencing of funds is necessary to provide the certainty and stability of income required for borrowing against revenues. Ringfenced TIF will, however, require some sort of rationing to prevent national debt from being too high and the pot of national business rates from falling too low.

We propose a light touch approach to TIF rationing in which the amount of TIF borrowing is capped as a proportion of business rates revenues within a LEP. Authorities, then, must present their business case to the LEP and be approved. This structure will ensure a sufficient national pot of business rates, maintain an acceptable level of national debt, vet local projects to ensure economic viability, and provide enough local freedom for places to support growth as they see fit.

In conclusion, our positions touch on those elements of the LGRR which we find most important to not only the success of reform but the success of England's cities and national economy. Based on the principles of designing good incentives, we are confident that the structure of the new local government financing mechanisms can be designed for growth.

Contact

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