HERTFORDSHIRE COUNTY COUNCIL

Agenda Item No
4

CABINET
MONDAY 13 OCTOBER 2003 AT 2.00 P.M.

LOCAL GOVERNMENT FINANCE - LOCAL AUTHORITY BUSINESS GROWTH INCENTIVES (LABGI) CONSULTATION

Report of the Chief Executive and the Finance

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Executive Members: Michael Janes and David Beatty

1. Purpose of the Report

1.1 To agree the response to the Government's consultation on the technical aspects of the Business Growth Incentives scheme.

2. Summary

2.1 The aim of the scheme is to reward local authorities, which promote business development in their areas by allowing them to keep a proportion of their local business rates.

2.2 The scheme will affect all English local authorities, except combined fire authorities and police authorities and will start in April 2005.

2.3 The consultation document proposes a number of options on the proportion of business rates that councils will be able to keep.

3 Conclusion

3.1 The Cabinet is invited to agree a response for submission to Government before 31 October.

4 Background

4.1 The legislation required to enable this scheme is contained within the Local Government Act 2003.

4.2 This consultation paper contains an assurance that the scheme is not intended to pre-empt the findings of the Balance of Funding Review, and is intended to complement the Business Improvement Districts (BIDs) initiative. BIDs is a way of promoting partnership working between local authorities and businesses, where the cost of improvements are met by a supplementary levy on businesses within that locality.

5 Summary of the Consultation Paper

5.1 The stated intentions of the scheme are:

(a) to create positive financial incentives for local authorities to work in partnership with business, Regional Development Agencies, Learning and Skills Councils and other key local and regional players to maximise economic growth; and

(b) that all local authorities irrespective of their economic circumstances should be able to benefit from the scheme. The aim of the proposals is to balance the need to maintain a strong incentive for existing high growth authorities with the need to provide equitable incentives and benefits to deprived and low growth authorities.

5.2 Under the current arrangements all business rate revenues are collected by local billing authorities and passed to central government. These revenues are then re-distributed to all authorities on a per capita basis.

5.3 This scheme would allow local authorities to retain some business rate revenues for encouraging business growth in their areas and they will then be free to decide how to spend the additional money.

5.4 The consultation document states that ‘no authority will lose, and there is no question of extra revenue from this scheme being offset against other income’.

5.5 The additional revenue would come from increases in the tax base not from increasing the tax on existing business.

5.6 The consultation document proposes a number of options on the proportion of business rates revenue that councils will be able to keep. The key factor is the setting of baselines. A baseline is the average growth in rateable values during a period before the scheme starts.

There are alternative methods for calculating the baseline. These are:

a) National Model: All authorities are grouped together into a single national baseline.

b) Regional Model: Local authorities are grouped according to the nine English Government Office Regions. This model would produce the highest level of benefit for Hertfordshire.

c) National Historic Growth Model: Local Authorities grouped into five groups of roughly even numbers according to historic growth patterns.

d) Sub Regional Model: A combination of the Regional and Historic Growth Models with local authorities first placed into regions and then subdivided into 3 groups according to historic growth.

e) Local Authority Model: Each local authority is treated individually and against its own historic average growth.

5.7 The Government favours the National Historic Growth and Sub Regional models.

5.8 The Government proposes to use the eight-year period from 1995 to 2003 to set the trend for the baseline when the scheme goes live on 1st April 2005. The Government does not believe there is a case for extending the trend beyond the 1st April 2003.

5.9 The other key issues for consultation concern the setting of:

a) Floors - the percentage growth above, which an individual authority must progress to benefit from the scheme. We have requested more information about how the floor will be calculated and are awaiting a response. It is likely to be lower than the baseline so an authority that managed only to maintain its historic level of growth would still benefit.

b) Scaling Factors - the proportion of revenues retained locally, the remainder will be added to the main pool. This element is linked to the floor and there are two delivery options:

   i) A high floor / high scaling factor. Under this option the floor would be set higher in relation to the baseline so fewer authorities would receive benefit from the scheme without improving performance. However, this would be compensated for by a high scaling factor, allowing retention of much more of the revenues above the floor

ii) A medium floor / medium scaling factor. Under this option, the floors would be set lower so that many more authorities would receive benefit, including those with relatively low growth. However, there would be a correspondingly lower scaling factor so authorities would be allowed to keep a smaller amount of revenues above the floor.

c) Ceilings - determine the maximum benefit to individual local authorities, any growth above this level will be returned to the pool. Early indications suggest these will have a limited impact on authorities as they will be set very high.

d) Sharing of revenue between tiers - the Government makes it clear that this scheme only applies to those authorities that could significantly impact on economic regeneration. Although the Government acknowledges the role of shire counties, it states that '*the business-local authority partnership that this scheme is designed to encourage may best be realised by focusing on the taxpayer relationship with the collecting authority. Shire counties… do not collect business rates and so this relationship may not be formed*'. The Government is also unsure how the additional revenue should be shared between the tiers of government in shire authorities. The consultation paper suggests two possible ways of distributing the revenue from this scheme. One is based on the formula spending shares which results in a split of 85:15 in favour of shire counties. The other is based on the economic development spend which results in an 85:15 split, but this time in favour of the shire districts. The Government believes this is a difficult area, and would be very interested in the views of consultees.

5.10 Based on the data provided (where the average growth rate in the business taxbase over the last three years for Hertfordshire as a whole is two per cent) in the consultation document, the County Council would benefit from all the five baseline models. The following table lists the amounts the authority would have received in the current financial year, using the formula spending share option (the split between shire counties and shire districts being 85:15 respectively), which represents the best case scenario for the County Council.

Baseline Models	**County** Share (85%) £m	Total **District** share (15%) £m
National	1.04	0.18
Regional	1.24	0.22
National Historic	0.34	0.06
Sub Regional	0.76	0.13
Local	0.54	0.10

5.11 The following table, based on the one in paragraph 5.10 above, provides an indication of the benefit to the County Council in the first year of the scheme depending on different rates of growth in the taxbase.

Baseline Models	% Growth in Business Rates Taxbase Value				
	1% £m	1.5% £m	2% £m	2.5% £m	3% £m
National	nil	nil	1.04	2.00	3.00
Regional	nil	0.20	1.24	2.20	3.20
National Historic	nil	nil	0.34	1.30	2.30
Sub Regional	nil	nil	0.76	1.72	2.72
Local	nil	nil	0.54	1.50	2.50

6 Financial Implications

6.1 If the revenues are to be shared between shire authorities, and based on the information and data provided in the consultation document, the County Council is likely to benefit from all the five baseline models.

6.2 The amount would very much depend on the method used for the sharing of revenues between the county and districts and how the growth rate is calculated beyond the first year of the scheme. The consultation paper makes no reference to the latter point and we are awaiting a response, together with a number of other queries, from the Office of the Deputy Prime Minister.

6.3 If the scheme had been introduced in 2003/04, in the best case scenario the County Council would have received approximately £1.2 million.

Background information referred to by the authors

1. *Written Ministerial Statement, Deputy Prime Minister*, Friday 4 July

2. *Local Authority Business Growth Incentives - A Consultation Paper,* July 2003, HM Treasury & Office of the Deputy Prime Minister

3. *Local Government Association Executive*, Briefing Note 24 July 2003

HERTFORDSHIRE COUNTY COUNCIL RESPONSE TO THE LOCAL AUTHORITY BUSINESS GROWTH INCENTIVES CONSULTATION

We welcome the opportunity to comment on the proposals for the technical working of the scheme contained within the Local Authority Business Growth Incentives consultation document dated July 2003.

Q.1. Do you agree with the principles for the scheme?

We welcome the recognition that economic development poses direct costs on local authorities (e.g. transport, environment, education, and housing) while the benefits accrue to others. We also agree with the Chancellor's assertion to the LGA Conference that local economic performance cannot be improved by central government but requires active regeneration strategies from local communities led by their local authorities. However these involve councils in significant costs for which it is right that they receive appropriate compensation .

We welcome the assurance that the scheme is not intended to pre-empt findings of the wide ranging review into the balance of funding in local government finance and all our comments are made on this basis.

Our comments elsewhere outline where we have concerns with the current proposals.

Q.2. Do you agree with using an eight year period for setting the trend?

An eight-year period for setting the trend would appear to be reasonable.

Q.3. Are there models for setting the baseline that the Government has not considered that need to be considered?

No.

Q.4. Which of the baseline models is your preferred option and why?

The National Baseline model is our preferred option, which the consultation paper acknowledges '*is the best predictor of future growth'*. This we regard as the key test of the incentive effect as the closeness of the model results to historical outcomes over the eight-year period has less bearing on the issue of 'what would have happened without the incentive?' than has the predictive power of the model for the second four year period. It is the least prone to severe distributional effects.

In the words of the consultation paper it is '*clearly the simplest model'* and '*probably the most understandable'*. Therefore we think the Government mistaken not to favour this model '*as a result of the incentive effect and distributional effect'*. We do not believe that it is appropriate to favour the National Historic Growth or Sub Regional Models on the basis of their generosity to the 15% of wards designated as enterprise areas as the vast majority of the country's population lives elsewhere. This would appear to be the strongest argument in favour of these models.

Q.5. Which of the two preferred options for floors and scaling factors (high/high and medium/medium) do you think provides the best balance between financial support and financial incentive?

The medium/medium option may be preferable to the high/high option. However, terms like 'medium' and 'high' are not helpful and therefore we cannot comment more fully.

Q.6. Do you agree with using formula spending shares as the measure for determining ceilings? Do you agree that a 1% ceiling in year one of the scheme rising in line with the scheme (i.e. reaching 3% in year three) provides an adequate balance of incentive and cap on gains?

The formula spending share would be the best measure for determining ceilings. However, we do not believe that the case for ceilings has been made. Before we could support the imposition of ceilings we would need to have it demonstrated that the benefits of the scheme for high growth authorities were substantially in excess of the costs of that growth.

Q.7. How do you think that benefits should be shared between different tiers of local government?

In general we believe that the costs of economic development are often spread over a wide area. To focus the benefits narrowly on where the development is taking place misses the point that people travel to work and their children are often educated near where they live. For this reason we believe that on grounds of spatial equity alone there is a strong case for the additional revenues generated by the scheme to be shared between the shire counties and shire districts.

Over and above this, economic development is a partnership activity involving many services and cannot be measured by the relatively small amount categorised as 'economic development expenditure'. Furthermore we believe the scheme should not be thought of as a means of funding extra economic development expenditure but of

achieving a better balance between the costs and benefits of economic development and that many of these costs will be related to mainstream services.
A further consideration is the fact that the national non-domestic rate covers not just business of course. Although we would not expect within this initiative to be rewarded for building more schools, even if this increases the NNDR contribution it does appear that many of the infrastructure costs for economic development, such as schools will fall to the shire authorities.

In addition, the Business Improvement Districts (BIDs) process will have a bearing on allocation of costs. Since BIDs will inevitably be established in Districts (probably town centres, industrial areas and particular wards or groups of wards) counties will be expected to be partners with little financial gain.

All these considerations point to 85 per cent of the additional revenues going to shire counties with the remaining 15 per cent to shire districts, which aligns with the formula spending option mentioned in the consultation document.

Q.8. (If you represent a local authority) Would you like to volunteer to be part of the administrative dry run?

Yes, Hertfordshire County Council does volunteer to take part in the administrative dry run.

Other Issues

We would also like the Government to consider the following issues in developing this scheme:

a) The scheme should not be used as a means of redistributing funds away from the south-east to other regions.

b) Our commuting population to London generates some 25% at least of "our" GDP - this is attributed to London’s GDP total/productivity. We know this figure to be the case by reference to the disparity between our GDP and household income figures.

The 2001 Census will no doubt reveal that the number of people from the county commuting to London to higher added value jobs is on the increase. This interdependency between London and Hertfordshire means that the proposal to set ceilings contingent on local growth of businesses is not simple, and indeed will require sophisticated attribution. Otherwise London will benefit from our labours, and the consequences of travel for Hertfordshire will be ignored.

c) The welfare of our communities is unlikely to be best served by a narrow focus on encouraging the growth of rateable value. Government is encouraging the growth of social enterprise and we are actively pursuing this agenda. This growth is unlikely to feed through into the same increases in rateable value, as would be the case with conventional commercial growth. Similarly among the 30,000 micro-businesses in Hertfordshire are many life-style entrepreneurs who choose not to grow their businesses. These contribute greatly to the well being of our communities and the maintenance of this contribution is a fitting goal for authorities, which will not be encouraged by the scheme's narrow focus on rateable value.